Seminar Guide

Agenda

Speakers' Biographies

Presentation Materials/ Supplements

Office of the Kansas Securities Commissioner

www.ksc.ks.gov

109 SW 9th Street, Suite 600

Topeka, KS 66612

785-296-3307

785-296-6872 (Fax)

Seminar Agenda

8:30 AM – 9:00 AM	**Check- In**
9:00 AM – 9:15 AM	**Opening Remarks by Kansas Securities Commissioner Josh Ney**
9:15 AM – 10:05 AM	**Registration: Filings and Disclosures** *Shelly Welch, BD/IA Registration Manager, KSC* This session will cover updates to the ADV, U-4, and U-5 forms, how to navigate pertinent registrant information on the KSC website, requirements for BD/IA registration (including solicitors), the three most important areas of disclosure on Part 2A, and will provide an introduction to our new IA Guidelines handbook.
10:05 AM – 10:15 AM	**Break**
10:15 AM – 11:05 AM	**Creating Effective Compliance Systems & Processes** *Jason Vinsonhaler, Senior Special Agent, KSC* This presentation will provide best practices for establishing the infrastructure necessary to maintain compliance with pertinent laws and regulations. Information will also be provided on the benefits and potential pitfalls of social media and other technology used by investment advisers and how those technologies fit in the overall compliance structure.
11:05 AM – 12:00 PM	**Compliance Roundtable** *Panel members include:* • *Randy Mullikin, Director of Enforcement & Compliance, KSC* • *Nicholas Madsen & Denise Saxon, Assistant Regional Directors, Denver Regional SEC Office* • *Jennifer Luginbill, Associate District Director, FINRA's Kansas City District Office* This presentation will focus on examinations of investment advisers and broker-dealers conducted by the staff of the KSC, SEC, and FINRA. Topics to be covered are how examinations are conducted, current priorities on examinations, Kansas Open Records Act, and cross-over broker-dealer activities.
12:00 PM – 12:45 PM	**Lunch**
12:45 PM – 1:15 PM	**Investor Education and Protection** *Shannon Stone, Caley Love, Chris Mann and Jason Vinsonhaler, KSC* Presenters will provide a brief overview of the Investor Education Fund including information on its development, priorities, programming and partnerships. The second part of this presentation will include an overview of the role of enforcement within the KSC. Common indicators of questionable opportunities will be presented to equip advisers to assist the agency in protecting the advisers' clients and other Kansas investors from suspicious investments.

1:15 PM – 2:15 PM **Responding to a Regulatory Investigation**

Panel members include:

- *Jeff Kruske, General Counsel, KSC*
- *Tom Piccone, Denver Associate Regional Director, SEC*
- *Amy E. Rush, VP & Senior Regulatory Counsel, Waddell & Reed, Inc.*
- *Jeff Jamieson, Resolution Compliance Counsel, Edward Jones & Co.*

Our speakers, who have been advocates in this active and complex arena (as prosecutors, defense counsel, plaintiff's counsel, and corporate counsel), will explain the general regulatory framework governing the securities industry and will present an in-depth discussion of some of the finer points and nuances of regulatory investigations.

2:15 PM – 2:45 PM **Administrative Enforcement and Procedures**

Ryan Kriegshauser, Director of Policy & Special Counsel, KSC

This presentation will focus on administrative proceedings in front of the Office of the Kansas Securities Commissioner's Office. Topics to be covered are an overview of the administrative process, interactions between the Kansas Uniform Securities Act and the Kansas Administrative Procedure Act, and best practices.

2:45 PM – 2:55 PM **Break**

2:55 PM – 3:45 PM **Regulatory Changes / Updates and Corporate Finance**

- *Steve Wassom, Randy Mullikin and Lynn Hammes, KSC*
- *Kenny Bossert, Assistant Regional Director, Denver Regional SEC Office*

This presentation by the KSC and SEC staff members will examine regulations governing the changes to financial requirements, the adoption by the KSC of the Private Adviser Exemption, and the overview by the SEC of the exemption for a "Family Office." It will also provide an overview of the more common exemptions from the securities registration requirements provided by the Kansas Uniform Securities Act and the Kansas Administrative Regulations.

3:45 PM – 4:00 PM **Closing Remarks by Jason Vinsonhaler, KSC**

Time will be allotted at the end of the day for informal networking and Q&A.

Josh Ney

Securities Commissioner

Office of the Kansas Securities Commissioner

The Kansas Senate confirmed Josh Ney for the position of Kansas Securities Commissioner on September 4, 2013. He had served as Acting Commissioner since February of 2013. Prior to his appointment, Mr. Ney served as a Special Assistant Attorney General and policy staff attorney for the office, handling securities fraud felony prosecutions and providing policy and legal support to the commissioner. In 2012, Mr. Ney authored a legal article entitled "Securities-Related Prosecution in Kansas: A Primer," published in the Fall/Winter 2012 edition of the Kansas Prosecutor, the legal publication of the Kansas County and District Attorneys Association. He came to the Securities Commissioner's Office in 2011 from a criminal law enforcement background, having served as the First Assistant County Attorney in Jefferson County, Kansas. As a county prosecutor, Mr. Ney handled a diverse caseload of person and non-person felony, misdemeanor, traffic, juvenile offender, and child in need of care matters. He has also practiced privately in northeast Kansas and has served as a city attorney, municipal prosecutor, and county counselor. Mr. Ney previously served on the Kansas Human Rights Commission as the Commissioner representing the Kansas legal profession. He was appointed by the Governor and confirmed by the Senate to that position and served from 2011-2013. Mr. Ney graduated with dean's honors from the Washburn University School of Law and served as a published staff writer on the Washburn Law Journal. He is a member of several professional organizations, including the Kansas Bar Association, the Kansas County and District Attorneys Association, Oskaloosa Rotary Club, and the Jefferson County Chamber of Commerce. Mr. Ney is active in his church in Lawrence, Kansas and lives on a farm with his wife, Carol, and their five children in rural Jefferson County.

Shelly Welch

BD/IA Registration Manager

Office of the Kansas Securities Commissioner

Shelly Welch has been with the office for 11 years and is currently the BD/IA Registration Manager. In that capacity, she reviews the registration applications for broker-dealer and investment adviser firms as well as their agents and representatives. As a Senior Examiner, Ms. Welch previously conducted broker-dealer and investment adviser examinations and helped train new Examiners. Prior to working for the Securities Commissioner, she was a Special Agent for the Kansas Attorney General and a paralegal for the State of Kansas and a private law firm. She graduated from Washburn University in Topeka, Kansas, and enjoys reading, watching her children's sporting and theater events, and spending time with family and friends.

Jason Vinsonhaler
Senior Special Agent
Office of the Kansas Securities Commissioner

Jason Vinsonhaler has been with the Office of the Kansas Securities Commissioner for 3 years and is currently a Senior Special Agent. In this role, he investigates alleged violations of Kansas securities law as a sworn law enforcement officer. He also continues to work in the compliance department, where he started with the office in 2011, conducting investment adviser and broker-dealer examinations. Prior to working for the Securities Commissioner, Mr. Vinsonhaler worked in the financial and insurance industries as an agent of a broker-dealer and an insurance adjuster. He is a graduate of Kansas State University in Manhattan, Kansas, and the Kansas Law Enforcement Training Center in Hutchinson, Kansas. Mr. Vinsonhaler enjoys spending time with family and friends, practicing martial arts, reading, and helping his children with their scouting activities and projects.

Randy Mullikin
Director, Compliance and Enforcement
Office of the Kansas Securities Commissioner

Randy Mullikin serves as the Director of Compliance and Enforcement and is responsible for the regulatory oversight of broker-dealers and investment advisers in Kansas as well as supervision of administrative and criminal investigations of alleged violations of the Kansas Uniform Securities Act and Kansas Loan Brokers Act. Mr. Mullikin began his regulatory career with the Office of the Securities Commissioner in 1997 as an investigator on enforcement cases alleging fraud, unregistered securities and unregistered loan brokers. Mr. Mullikin has also served as Examiner for NASD from 2002 to 2005 assigned to the Boston District Office. In 2006, he rejoined the KSC office and became Assistant Director of Compliance. From 2006 to 2011, Mr. Mullikin served as volunteer member of the NASAA (North American Securities Administrators Association) Investment Adviser Training Project Group. Prior to his regulatory career, he served for 20 years as a member of the Wichita Police Department, retiring in 1997 at the rank of sergeant. Mr. Mullikin resides in Wichita with his wife Carol. He is a graduate of Friends University with a bachelor's degree in History.

Not Available

Nicholas F. Madsen
Assistant Regional Director
U.S. Securities & Exchange Commission, Denver Regional Office

Nicholas F. Madsen is an Assistant Regional Director for the investment adviser and investment company examination program in the Securities and Exchange Commission's Denver Regional Office. Mr. Madsen joined the SEC's staff in 2003, initially serving as a Staff Accountant for the broker-dealer examination program in the SEC's Chicago Regional Office, then transitioning to the same role in the in the Denver Regional Office's investment adviser and investment company examination program. In 2010, Mr. Madsen became an Examination Manager in the Denver Regional Office investment adviser and investment company examination program before moving into his current position in 2014. He graduated with honors from the University of Wisconsin-La Crosse College of Business Administration in 2003, majoring in finance and minoring in accounting; and he became a CPA in Illinois (current status inactive) in 2006. Prior to joining the SEC, Mr. Madsen worked at a branch office of A.G. Edwards & Sons, Inc.

Not Available

Denise S. Saxon
Co-Acting Associate Regional Director
U.S. Securities & Exchange Commission, Denver Regional Office

Denise Saxon is currently Co-Acting Associate Regional Director and also Assistant Regional Director for the Broker-Dealer/Transfer Agent Examination Program in the Securities and Exchange Commission's Denver Regional Office. In this position, she is responsible for identifying and managing examinations with a view toward preventing fraud, improving compliance in the industry, monitoring for risk, and informing SEC policy. Prior to joining the SEC's Denver Office, she was an Associate General Counsel of Fiserv Investment Support Services in Denver, Colorado, where she provided legal counsel to a trust company and affiliated brokerage firm on a wide range of securities, contract, and privacy related matters. Prior to that, Ms. Saxon was an Associate in the Investment Management Practice Group of Morgan Lewis in Washington, DC and Los Angeles, California; a Staff Attorney and Branch Chief in the SEC's Office of Compliance Inspections and Examinations in Washington, DC; and an Examiner and Regulatory Coordinator with the NASD (now FINRA) in Denver, Colorado and Washington, DC. Ms. Saxon holds a BSBA in Finance from Creighton University; a JD from the University of Denver; and a LLM, *with distinction*, in Securities and Financial Regulation from Georgetown University. She is admitted to the State of Colorado and DC Bars.

Not Available

Jennifer Luginbill
Associate District Director
FINRA's Kansas City District Office

Jennifer Anne Luginbill is the Associate District Director of FINRA's Kansas City District Office where she oversees the planning and execution of the Kansas City District Office's cycle and cause programs and is responsible for guiding staff in the development of investigations and regulatory matters. Ms. Luginbill began her career with NASD in 2000 as a Compliance Examiner conducting routine examinations of member firms and completing cause related investigations. Prior to joining NASD/FINRA, Ms. Luginbill obtained banking and financial experience while employed at a regional bank broker-dealer in several different capacities including registered investment representative. In addition, Ms. Luginbill was also employed as a Compliance Examiner for the Kansas Securities Commissioner's Office where she was responsible for reviewing both Broker-Dealers and Investment Advisers for regulatory compliance. She holds a B.S. in Business Administration from Drake University and obtained the Certified Regulatory and Compliance Professional (CRCP) designation from the FINRA Institute at Wharton in 2008.

Shannon Stone
Director, Investor Education
Office of the Kansas Securities Commissioner

Shannon Stone serves as the Director of Investor Education at the Office of the Kansas Securities Commissioner. In this capacity, she oversees and promotes comprehensive financial literacy programming for Kansans of all ages. Ms. Stone has served in the public sector for the past 17 years, beginning her professional career as a teacher for Topeka Public Schools in 1997. From 2003 to 2011, she worked for United States Senator Sam Brownback. Ms. Stone is a graduate of the Eisenhower Women's Leadership Series, an active member of her church, and enjoys spending time with her family. She is a graduate of Kansas State University and holds a bachelor's degree in Education.

Caley Love
Director, Communications
Office of the Kansas Securities Commissioner

Caley Love is the Director of Communications at the Office of the Kansas Securities Commissioner. In the Director's capacity, she coordinates all communication from the Commissioner's office to the public. Ms. Love holds a B.A. from Washburn University and an M.B.A. from Fort Hays State University with an emphasis in Marketing. Prior to her experience at the Office of the Kansas Securities Commissioner, she served as Student Body President at Washburn University. From 2010-2012, she served as Communications Director for, her now husband, Garrett Love's campaign for Kansas Senate. Ms. Love enjoys graphic design and photography, and in 2012, started her own photography business. She is a member of the Kansas Association of Public Information Officers, the Eisenhower Women's Leadership Series and also was appointed by the Governor to serve on the Kansas Advisory Group on Juvenile Justice and Delinquency Prevention.

Chris Mann
Senior Staff Attorney
Office of the Kansas Securities Commissioner

Chris Mann has been with the Office of the Kansas Securities Commissioner since October of 2013 and is a Senior Staff Attorney and Special Assistant Attorney General. Mr. Mann handles complex criminal, civil and administrative cases along with the other members of the legal department. Prior to joining the office, he was an Assistant District Attorney at the Wyandotte County District Attorney's Office, where he handled a large felony caseload. Mr. Mann also teaches criminal law courses and lectures on trial advocacy. Before graduating from Washburn School of Law and becoming an attorney, Mr. Mann was a police officer in Lawrence, Kansas.

Jeffrey Kruske
General Counsel
Office of the Kansas Securities Commissioner

Jeffrey Kruske is the General Counsel for the Kansas Securities Commissioner. He received his undergraduate degree in Business Administration from William Jewell College and his law degree from Washburn University School of Law. Prior to joining the agency, Mr. Kruske maintained a private legal practice, concentrating in securities arbitration and in related estate, trust and business litigation matters, both regionally and nationally. He also represented individual brokers in employment-related disputes with brokerage firms. Mr. Kruske frequently lectures on the topics of securities arbitration and litigation, and has authored articles on the same topic in the Journal of the Kansas Trial Lawyers Association, the Kansas Bar Journal, the Johnson County Bar Letter, and the Kansas City Star. He is a member of the Johnson County, Kansas and Missouri Bar Associations, Kansas City Metropolitan Bar Association, the Public Investors Arbitration Bar Association, and has been an arbitrator for the Financial Industry Regulatory Authority and the National Futures Association. Mr. Kruske was listed in the 2008, 2009, 2010 and 2011 Kansas/Missouri Superlawyers Rising Stars for securities litigation.

Not Available

Thomas M. Piccone
Associate Regional Director
U.S. Securities & Exchange Commission, Denver Regional Office

Thomas M. Piccone is the Associate Regional Director managing the examination program in the Securities and Exchange Commission's Denver Regional Office ("DRO"). Mr. Piccone joined the Commission's staff in 1997, and worked in the Enforcement Division as an Attorney, Branch Chief, Trial Counsel, and Special Counsel before transitioning into the Commission's examination program. He served as the Assistant Regional Director for the DRO's investment adviser and investment company examination program from 2009 until moving into his current position in 2014. Prior to joining the SEC, Mr. Piccone worked as an attorney with Gibson, Dunn & Crutcher LLP, where his practice emphasized litigation involving accounting and securities. He also served as a law clerk for U.S. District Court Judge Alfred A. Arraj, and prior to law school he was employed as a member of the management information consulting division of Arthur Andersen & Co. Mr. Piccone received his bachelor's degree in business (accounting) *magna cum laude* from the University of Colorado at Boulder in 1983. He earned his law degree from the University of Colorado Law School in 1987, where he was awarded the Order of the Coif. He became a certified public accountant in Colorado (currently inactive) in 1988. Mr. Piccone has worked with a number of civic and charitable organizations in the Denver area, including serving as a member of the Board of Directors of Easter Seals Colorado and as the President of the Governing Board (Board of Directors) of Littleton Preparatory Charter School.

Amy E. Rush
Vice President and Senior Regulatory Counsel
Waddell & Reed, Inc.

Ms. Rush's area of specialization at Waddell & Reed is regulatory affairs. Ms. Rush's main responsibility is to respond on behalf of the broker dealers (Waddell & Reed, Inc. and Ivy Funds Distributor, Inc.) regarding issues of regulatory concern. In this capacity, Ms. Rush interacts with the SEC, FINRA, State Attorney Generals, the Labor Department, State Securities and Insurance Commissioners and counsel for claimants. Prior to joining Waddell & Reed, Ms. Rush was employed by a national law firm, Sonnenschein Nath & Rosenthal, as a trial attorney. Ms. Rush's areas of expertise were Securities Litigation and Complex Commercial Litigation. While at Sonnenschien, Ms. Rush represented clients in NASD and NYSE arbitrations, NASD regulatory inquiries, SEC inquiries, trade secret and unfair competition disputes, non-competition agreement disputes, breach of contract disputes, bankruptcy litigation, bankruptcy preference matters, and insurance company extra-contractual liability cases. Prior to law school, Ms. Rush focused on marketing and management, obtaining international recognition as the Kansas City Marketing Coordinator for American-Multi Cinema. During law school, she was an editor of the Law Review at the University of Missouri-Kansas City Law School and a published author. Ms. Rush is highly involved in community and professional association activities. She is Past President of the Kansas City Hispanic Bar Association, an alumnus of the Inn of Court, and a member of The Missouri Bar and Kansas Bar. Ms. Rush is admitted to practice law in both Missouri and Kansas.

Not
Available

Jeff Jamieson
Resolution Compliance Counsel
Edward Jones & Co.

A 1983 graduate of the University of Missouri law school and a longtime resident of St. Louis, Missouri, Mr. Jamieson has worked continuously in the securities industry since 1991. He currently works for Edward Jones' Compliance Resolution Department where his duties include responding to regulatory inquiries. For ten years before joining Edward Jones, he was part of a securities practice group at Husch Blackwell and Bryan Cave. He spent the twelve years before going into private practice at A.G. Edwards.

Mr. Jamieson has extensive regulatory and litigation experience having represented clients before FINRA, the NYSE, the SEC and various state regulatory agencies.

Ryan Kriegshauser
Director of Policy and Special Counsel
Office of the Kansas Securities Commissioner

Ryan Kriegshauser serves as Director of Policy and Special Counsel at the Office of the Kansas Securities Commissioner. Prior to joining the agency, Mr. Kriegshauser served as the Deputy Assistant Secretary of State for the Office of Legal Counsel and Policy. He has also served on the Kansas Judicial Counsel's Lien Law Advisory Committee, the State Rules and Regulation Board, was a member of the Kansas Bar Association's Limited Liability Company Study Group, and was a voting member of the Kansas Governor's Commission on Emergency Planning & Response (CEPR) Continuity of Operations (COOP) Planning Committee. Before entering public service, Mr. Kriegshauser practiced law in Kansas City, primarily focusing in the areas of complex commercial litigation, securities, and constitutional rights. He was involved in the successful defense of various class action lawsuits and governmental regulatory actions. Additionally, Mr. Kriegshauser has written scholarly articles on property rights and taught continuing legal education in Kansas. Mr. Kriegshauser spent two years working in Washington, DC, both on and off Capitol Hill. He holds a B.A. and a J.D., graduating from Georgetown University and the University of Missouri at Kansas City. He is also an alumnus of the Fund for American Studies – Bryce Harlow Institute of Business-Government Affairs. In his spare time, he proudly serves as an officer in the Navy Reserve. He currently resides in Topeka, Kansas, with his wife Christie.

Steve Wassom
Executive Director
Office of the Kansas Securities Commissioner

Steve Wassom is the Executive Director at KSC after previously serving as Director of Finance and Administration from 1996 to 2011, and Chief Securities Regulatory Auditor from 1983 to 1996. He has served as Interim Securities Commissioner on two occasions between appointments of Commissioners in 1996 and 2010. Mr. Wassom was in public practice with a national CPA firm in Wichita and Topeka, Kansas from 1976 to 1983. In 1974 and 1975, he was employed as a Business Manager / Controller for a private business and was an adjunct faculty member at a private liberal arts college. Mr. Wassom is a member of the American Institute of Certified Public Accountants and the Kansas Society of Certified Public Accountants (KSCPA) and has served on several KSCPA committees. He served as Chairman of the Non-Profit Debt Offerings Project Group for the Corporate Finance Section of the North American Securities Administrators Association, Inc. (NASAA) during 2001 through 2004. He previously served on the NASAA Small Business Project Group, participated in organizing the Midwest Regional Review Program, and continues to be involved with various other NASAA activities and conferences. NASAA presented an Outstanding Service Award to him at the 85th Annual Conference in Philadelphia, Pennsylvania on September 29, 2002. Mr. Wassom obtained his bachelor's degree in psychology with a minor in business, and his MBA in management from Kansas State University. He completed post-graduate coursework in accounting at Wichita State University and became a certified public accountant in 1978 and has maintained a permit to practice in Kansas since that time.

Lynn Hammes
Director, Finance and Administration
Office of the Kansas Securities Commissioner

Lynn Hammes has been with the Office of the Kansas Securities Commissioner since 2003 and currently serves as Director, Finance and Administration. In this position he is primarily responsible for securities registration and financial reporting of registrants, as well as serving as the Chief Financial and Administrative Officer of the agency. He has over 40 years of experience in the areas of accounting, finance, operations, and leadership in both the public and private sector. Prior to joining the Office of the Securities Commissioner he served as an executive officer of a publicly held company whose shares traded on the New York Stock Exchange. In that capacity he was involved in bringing a number of public offerings to market. Mr. Hammes served on the NASAA Direct Participation Programs Policy Project Group from 2006 - 2012, and on the Non-Profit Debt Offerings Project Group from 2004 - 2005. A Kansas native, Mr. Hammes received his B.S. degree in Business Administration with an Accounting emphasis from Kansas State University in 1973. He resides in Topeka with his wife Kristin.

Not Available

Kenneth Bossert

Assistant Regional Director

U.S. Securities & Exchange Commission, Denver Regional Office

Kenneth Bossert serves as an Assistant Regional Director in the Investment Adviser/Investment Company examination program for the Office of Compliance Inspections and Examinations in the U.S. Securities and Exchange Commission's Denver Regional Office. Most recently, he served as an Examination Manager in the SEC Broker-Dealer examination program in the Denver Regional Office. Prior to 2010, he spent five years working in the Los Angeles Regional Office of the SEC in the Investment Adviser/Investment Company examination program. Before joining the SEC, Mr. Bossert worked in public accounting with KPMG and as a financial analyst for several large firms. He holds a B.B.A. degree from The University of North Texas and an M.B.A. from Southern Methodist University in Dallas, TX. Mr. Bossert is also a C.P.A. licensed in the state of California.

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Registration Filings and Disclosures

By Shelly Welch

Kansas

Office of the Securities Commissioner

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OFFICE OF THE KANSAS SECURITIES COMMISSIONER

REGISTRATION FILINGS AND DISCLOSURES

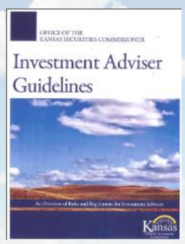
Presenter: Shelly Welch

Kansas
Office of the Securities Commissioner

Slide 2

Resources

- KSC Website- www.ksc.ks.gov
- New Investment Adviser Guidelines Booklet



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Slide 3

Question: Do you regularly visit our website for updates and current issues?

- Yes
- No

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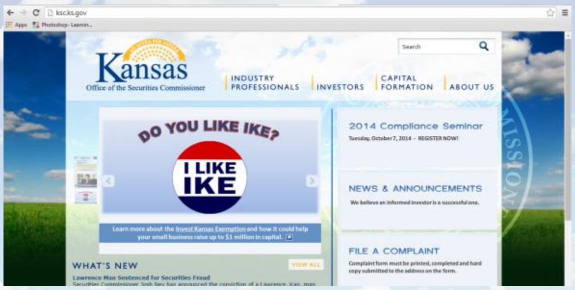
Slide 4

KSC Website Homepage



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Tab: Industry Professionals

- Compliance & Registration
- Broker-Dealers
- Investment Advisers
- Industry Links
- Kansas Uniform Securities Act
- Kansas Securities Regulations
- 2014 Compliance Seminar

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Tab: Investment Advisers

- IA Registration Requirements
- IA Representative Registration Requirements
- IA Notice Filing Requirements
- IA Disclosure Check
- IARD Information and Forms
- IA Statutes and Regulations
- IA FAQs

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Tab: IARD Information and Forms

- Re-directed to NASAA website
- Form ADV
  - Instructions/Glossary
  - Part 1 (A & B)
  - Part 2
    - Firm Brochure (2A)
    - Wrap Fee Brochure
    - Brochure Supplement (2B)

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Regulatory Filings

- Annual Renewal
- Annual Updating Amendments to Form ADV
  - Part 1A & 1B
  - Part 2A
  - Part 2B
- Other Updates and Amendments to Form ADV
- Form U-4
- Form U-5
- Form ADV-W

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Annual Renewal

- Letter from our office in November
- Renewal fees due to IARD in December
- FINRA Gateway Call Center:

  (240) 386-4848

Slide 10

Question: If your fiscal year end is Dec. 31, can you submit your firm's annual updating amendment to Form ADV on Dec. 29?

- Yes
- No

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Slide 11

When am I required to update my Form ADV?

- Annual Updating Amendments
  - Within 90 days of fiscal year end
  - Update responses to all items
  - Summary of material changes in Item 2 or as exhibit to 2A
  - Part 2B may be confirmed

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When am I required to update my Form ADV?

- Other-than-Annual Amendments
  - Promptly (within 30 days)
  - Part 1A
    - *If inaccurate in any way: Items 1, 3, 9 [except 9A(2), 9B(2), 9E and 9F] or 11
    - *If materially inaccurate: Items 4, 8, or 10
  - Part 1B
    - *If inaccurate in any way: Items 1, 2A through 2F, or 2I
    - *If materially inaccurate: Item 2G
  - Part 2A and 2B
    - *If materially inaccurate

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When am I required to update my Form ADV?

- Other-than-Annual Amendment Update Exceptions
  - Part 1A- Not required to update Items 2, 5, 6, 7, 9A(2), 9B(2), 9E, 9F or 12
  - Part 1B- Not required to update Items 2H or 2J
  - Part 2A- Not required to update Item 2, client asset calculations or fee changes
- EVEN IF YOUR RESPONSES TO THOSE ITEMS HAVE BECOME INACCURATE

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When am I required to update my Form ADV?

- Caveat: Not required to update brochure between annual amendments solely because amount of client assets you manage has changed or because fee schedule has changed; however, if you update your brochure for a separate reason in between annual amendments and the amount of client assets you manage listed in response to Item 4E or your fee schedule in Item 5A has become materially inaccurate, you should update those items as part of the interim amendment

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Delivery of Updates and Amendments

- To clients promptly (within 30 days) if information in brochure or brochure supplement becomes materially inaccurate

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Question: Under Kansas regs, if an IA rep has an amendment to their Form U-4, how many days do they have to update the form?

A) 10 days

B) 30 days

C) 90 days

D) As long as they want

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Form U-4 Updates and Disclosures

- Individual responsible for updates
- Continuing obligation
- Update within 30 days of event requiring amendment

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Question: What type of disclosure event is most often reported late or not reported at all?

A) Criminal charges

B) Customer complaints

C) Regulatory actions

D) Bankruptcies/liens

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Form U-5

- Filed by firm when IAR is terminated or discharged
- Regulation requires filing immediately

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Form ADV-W

- Firm files if withdrawing from registration
- All associated investment adviser representatives (IARs) cease to be registered

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Brochure Disclosures

- 3 Most Important
  1. Description of Business
  2. Conflicts of Interest
  3. Fees

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Description of Business- Part 2A, Item 4

- Plain English language required.
- Types of services offered- are they limited to specific types of investments?
- Tailored to individual client needs?
- Restrictions allowed?

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Conflicts of Interest- Part 2A

- Item 10- Other Financial Industry Activities and Affiliations
- Item 11 - Participation or Interest in Client Transactions and Personal Trading
- Item 12- Brokerage Practices (Research and Soft Dollar)
- Item 14- Economic Benefit from a Non-Client

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Fees- Part 2A, Item 5

- Fee schedule- type and how often
- Direct deduction or billed
- Other fees (custodial, mutual fund, etc.)
- In advance or in arrears
- Refund policy
- Commissions accepted in addition to advisory fees

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Registration Filings and Disclosures
Questions?
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Supplemental Materials:

Registration Filings and Disclosures

By Shelly Welch

Kansas
Office of the Securities Commissioner

FORM ADV GENERAL INSTRUCTIONS

PAGES 3 & 4

Part 1A also contains several supplemental schedules. The items of Part 1A let you know which schedules you must complete.

- Schedule A asks for information about your direct owners and executive officers.
- Schedule B asks for information about your indirect owners.
- Schedule C is used by paper filers to update the information required by Schedules A and B (see Instruction 16).
- Schedule D asks for additional information for certain items in Part 1A.
- Disclosure Reporting Pages (or DRPs) are schedules that ask for details about disciplinary events involving you or your *advisory affiliates*.

- Part 1B asks additional questions required by *state securities authorities*. Part 1B contains three additional DRPs. If you are applying for SEC registration or are registered only with the SEC, you do not have to complete Part 1B. (If you are filing electronically and you do not have to complete Part 1B, you will not see Part 1B.)

- Part 2A requires advisers to create narrative *brochures* containing information about the advisory firm. The requirements in Part 2A apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.

- Part 2B requires advisers to create *brochure supplements* containing information about certain *supervised persons*. The requirements in Part 2B apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.

4. **When am I required to update my Form ADV?**

- <u>SEC- and State-Registered Advisers</u>:

  - <u>Annual updating amendments</u>: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all items, including corresponding sections of Schedules A, B, C, and D. You must submit your summary of material changes required by Item 2 of Part 2A either in the *brochure* (cover page or the page immediately thereafter) or as an exhibit to your *brochure*.

  - <u>Other-than-annual amendments</u>: In addition to your *annual updating amendment*, if you are registered with the SEC or a *state securities authority*, you must amend your Form ADV, including corresponding sections of Schedules A, B, C, and D, by filing additional amendments (other-than-annual amendments) <u>promptly</u> if:

    - information you provided in response to Items 1, 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B becomes inaccurate in any way;

- information you provided in response to Items 4, 8, or 10 of Part 1A or Item 2.G. of Part 1B becomes materially inaccurate; or
- information you provided in your *brochure* becomes materially inaccurate (see note below for exceptions)

Notes: Part 1: If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., 9.F., or 12 of Part 1A or Items 2.H. or 2.J. of Part 1B even if your responses to those items have become inaccurate.

Part 2: You must amend your *brochure supplements* (see Form ADV, Part 2B) promptly if any information in them becomes materially inaccurate. If you are submitting an other-than-annual amendment to your *brochure*, you are not required to update your summary of material changes as required by Item 2. You are not required to update your *brochure* between annual amendments solely because the amount of *client* assets you manage has changed or because your fee schedule has changed. However, if you are updating your *brochure* for a separate reason in between annual amendments, and the amount of *client* assets you manage listed in response to Item 4.E or your fee schedule listed in response to Item 5.A has become materially inaccurate, you should update that item(s) as part of the interim amendment.

- If you are an SEC-registered adviser, you are required to file your *brochure* amendments electronically through IARD. You are not required to file amendments to your *brochure supplements* with the SEC, but you must maintain a copy of them in your files.
- If you are a state-registered adviser, you are required to file your *brochure* amendments and *brochure supplement* amendments with the appropriate *state securities authorities* through IARD.

- Exempt reporting advisers:
  - Annual Updating Amendments: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all required items, including corresponding sections of Schedules A, B, C and D.
  - Other-than-Annual Amendments: In addition to your *annual updating amendment*, you must amend your Form ADV by filing additional amendments (other-than-annual amendments) promptly if:
    - information you provided in response to Items 1, 3, or 11 becomes inaccurate in any way; or

FORM ADV, PART 2A INSTRUCTIONS

RE: UPDATES TO BROCHURE

Instructions for Part 2A of Form ADV: Preparing Your Firm *Brochure*

1. To whom must we deliver a firm *brochure*? You must give a firm *brochure* to each *client*. You must deliver the *brochure* even if your advisory agreement with the *client* is oral. See SEC rule 204-3(b) and similar state rules.

   If you are registered with the SEC, you are not required to deliver your *brochure* to either (i) *clients* who receive only *impersonal investment advice* from you and who will pay you less than $500 per year or (ii) *clients* that are SEC-registered investment companies or business development companies (the *client* must be registered under the Investment Company Act of 1940 or be a business development company as defined in that Act, and the advisory contract must meet the requirements of section 15(c) of that Act). See SEC rule 204-3(c).

   Note: Even if you are not required to give a *brochure* to a *client*, as a fiduciary you may still be required to provide your *clients* with similar information, particularly material information about your conflicts of interest and about your disciplinary information. If you are not required to give a *client* a *brochure*, you may make any required disclosures to that *client* by delivery of your *brochure* or through some other means.

2. When must we deliver a *brochure* to *clients*?

   - You must give a firm *brochure* to each *client* before or at the time you enter into an advisory agreement with that *client*. See SEC rule 204-3(b) and similar state rules.

   - Each year you must (i) deliver, within 120 days of the end of your fiscal year, to each *client* a free updated *brochure* that either includes a summary of material changes or is accompanied by a summary of material changes, or (ii) deliver to each *client* a summary of material changes that includes an offer to provide a copy of the updated *brochure* and information on how a *client* may obtain the *brochure*. See SEC rule 204-3(b) and similar state rules.

   - You do not have to deliver an interim amendment to *clients* unless the amendment includes information in response to Item 9 of Part 2A (disciplinary information). An interim amendment can be in the form of a document describing the material facts relating to the amended disciplinary event. See SEC rule 204-3(b) and similar state rules.

   Note: As a fiduciary, you have an ongoing obligation to inform your *clients* of any material information that could affect the advisory relationship. As a result, between *annual updating amendments* you must disclose material changes to such information to *clients* even if those changes do not trigger delivery of an interim amendment. See General Instructions for Part 2 of Form ADV, Instruction 3.

3. May we deliver our *brochure* electronically? Yes. The SEC has published interpretive guidance on delivering documents electronically, which you can find at <www.sec.gov/rules/concept/33-7288.txt>.

4. When must we update our *brochure*? You must update your *brochure*: (i) each year at the time you file your *annual updating amendment*; and (ii) promptly whenever any information in the *brochure* becomes materially inaccurate. You are not required to update your *brochure* between annual amendments solely because the amount of *client* assets you manage has changed or because your fee schedule has changed. However, if you are updating your *brochure* for a separate reason in between annual amendments, and the amount of *client* assets you manage listed in response to Item 4.E or your fee schedule listed in response to Item 5.A has become materially inaccurate, you should update that item(s) as part of the interim amendment. All updates to your *brochure* must be filed through the IARD system and maintained in your files. See SEC rules 204-1 and 204-2(a)(14) and similar state rules.

5. We are filing our *annual updating amendment*. The last *brochure(s)* that we filed does not contain any materially inaccurate information. Do we have to prepare a summary of material changes? No, as long as you

PowerPoint Presentation:

Creating Effective Compliance Systems and Processes

By Jason Vinsonhaler

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Kansas

Office of the Securities Commissioner

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OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Creating Effective Compliance Systems and Processes

Presenter: Jason Vinsonhaler

Kansas
Office of the Securities Commissioner

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Slide 2

Supervisory Procedures

- Requirements [K.A.R. 81-14-10(a)(2)]
- Where to Find Regulatory Updates
  - www.ksc.ks.gov

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Slide 3

Considerations for Developing Effective Procedures

- [K.A.R. 81-14-10(a)(2)(A-I)]
- Tailor procedures to your business.
- Do not include unnecessary or "boiler plate" material.

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Considerations for Developing Effective Procedures

- Ensure staff are up to date on any regulatory changes.
- Update procedures as necessary.

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Detecting and Preventing Violations

- Annual Internal Review [K.A.R 81-14-10(a)(1)]
  - Client File Contents
  - ADV up to date
  - Procedures current

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Detecting and Preventing Violations

- Client Information Updates [K.A.R. 81-14-4(b)(18)]
- Trade Review
- Client File Review

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Recordkeeping

- Requirements
  - –[K.S.A. 17-12a411(c)(1)]
  - –[K.A.R. 81-14-4]
- IAR U4 File [K.A.R. 81-14-4(b)(21)]
- Check Logs [K.A.R. 81-14-4(b)(22)]

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Recordkeeping

- Custody defined [K.A.R. 81-14-9(a)(1)]
  - (A) Holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them or the ability to appropriate them.
    - Possession of client funds or securities unless received inadvertently and returned promptly (3 business days)
    - General power of attorney
    - Trustee of a trust, general partner of a limited partnership, managing member of an LLC or a comparable position for a pooled investment vehicle.

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Recordkeeping

- Custody defined [K.A.R. 81-14-9(a)(1)] (cont'd)
  - (B) Receipt of checks from clients payable to an unrelated third-party do not meet the definition of custody if the IA forwards the check to the third party within three days of receipt and maintains records in accordance with K.A.R. 81-14-4(b)(22).

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Recordkeeping

- Financial Records and Requirements
  - [K.A.R. 81-14-4(b)(6)]
  - Solvency [K.A.R. 81-14-9(d)]

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What social media outlets to you use most often?

a) Facebook
b) Twitter
c) LinkedIn
d) Pinterest
e) Instagram
f) YouTube
g) Other

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Social Media and Technology

- Defining Social Media
  - Facebook, Twitter, LinkedIn, Pinterest, Instagram, YouTube, Etc.
- Blogs, Forums, Online Commentary

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Social Media and Technology

- Online Content and Communication
  - Static Content
    - Blog or "wall" posts
    - Retention issues – leaving content online too long.
  - Real-time Electronic Communication
    - Considered a "Public Appearance"

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Social Media and Technology

- Online Content and Communication
  - Third Party Posts
    - Entanglement – firm involved in preparation of the content.
    - Adoption – firm explicitly or implicitly endorsed or approved content.
    - Linking to Third Party content.

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Social Media and Technology

- Online Content and Communication
  - Third Party Posts
    - Establish appropriate usage guidelines for those allowed to post on firm-sponsored websites.
    - Establish processes for screening third-party content.
    - Disclose firm policies regarding its responsibility for third-party posts.

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Social Media and Technology

- Online Content and Communication
  - Other Considerations:
    - News Feeds
    - Streaming Quotes
    - Google ads (or similar)

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Social Media and Technology

- Recordkeeping and Supervision
  - Advertising [K.A.R. 81-14-4(b)(11)]
    - Testimonials
    - Monitoring and Approval
    - Recordkeeping
  - Written Communication [K.A.R. 81-14-4(b)(7)(A)]
    - Recordkeeping

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Social Media and Technology

- Mobile Devices
  - Text Messaging Issues
  - SnapChat, et al.

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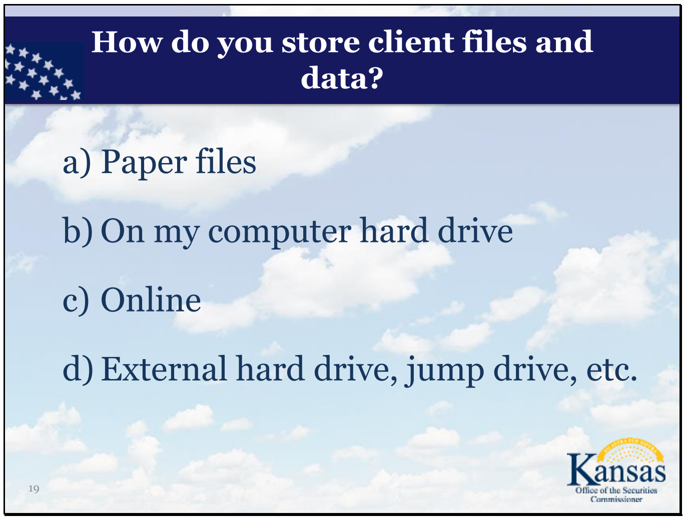

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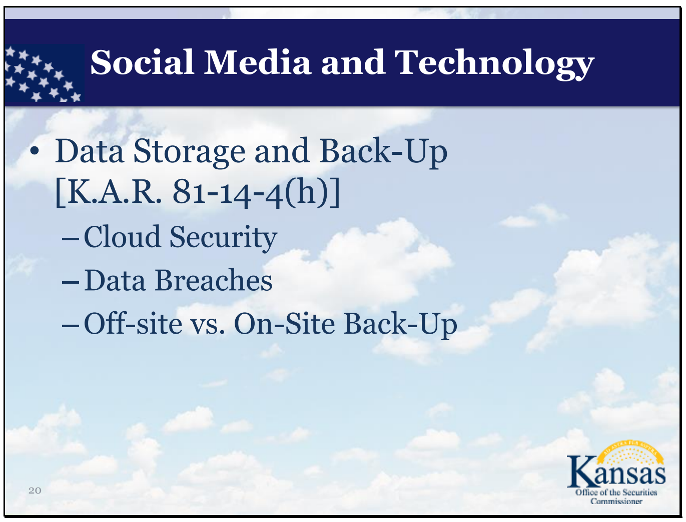

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Supplemental Materials:

Creating Effective Compliance Systems and Processes

By Jason Vinsonhaler

Kansas
Office of the Securities Commissioner

Regulatory Notice 10-06

Social Media Web Sites

Guidance on Blogs and Social Networking Web Sites

January 2010

Notice Type
- Guidance

Suggested Routing
- Advertising
- Compliance
- Legal
- Operations
- Registered Representative
- Senior Management

Key Topics
- Blogs
- Communications with the Public
- Recordkeeping
- Social Networking Web Sites
- Supervision

Referenced Rules & Notices
- ICA Section 24(b)
- NASD Rule 2210
- NASD Rule 2310
- NASD Rule 2711
- NASD Rule 3010
- NASD Rule 3070
- NASD Rule 3110
- NYSE Rule 351
- NYSE Rule 401A
- NYSE Rule 410
- NYSE Rule 472
- NTM 01-23
- NTM 03-33
- Regulatory Notice 07-59
- Regulatory Notice 09-55
- SEA Rule 17a-3
- SEA Rule 17a-4
- Securities Act Rule 482

Executive Summary

Americans are increasingly using social media Web sites, such as blogs and social networking sites, for business and personal communications. Firms have asked FINRA staff how the FINRA rules governing communications with the public apply to social media sites that are sponsored by a firm or its registered representatives. This *Notice* provides guidance to firms regarding these issues.

Questions concerning this *Notice* may be directed to:

- Joseph E. Price, Senior Vice President, Advertising Regulation/Corporate Financing, at (240) 386-4623; or
- Thomas A. Pappas, Vice President and Director, Advertising Regulation, at (240) 386-4500.

Background

According to a recent report by the Pew Internet and American Life Project, 46 percent of American adults who use the Internet logged onto a social networking site in 2009, which is up from 8 percent in 2005.[1] Other studies have shown that use of social media sites by businesses to communicate with customers and the public has grown significantly in the past few years.[2]

FINRA has provided guidance concerning particular applications of the communications rules to interactive Web sites in the past. For example, in March 1999, FINRA stated that a registered representative's participation in an Internet chat room is subject to the same requirements as a presentation in person before a group of investors.[3] This guidance was codified in 2003, when FINRA defined the term "public appearance" in NASD Rule 2210 to include participation in an interactive electronic forum.[4]

FINRA
Financial Industry Regulatory Authority

FINRA also has provided guidance regarding the application of the communication rules in its *Guide to the Internet for Registered Representatives*,[5] and has released podcasts on these issues to help educate firms and their personnel.[6] Nevertheless, FINRA staff has continued to receive numerous inquiries from firms and others concerning how the FINRA rules governing communications with the public apply to the use of social media sites by firms and their registered representatives. Firms also have inquired regarding their recordkeeping responsibilities for communications posted on social media sites.

In September 2009, FINRA organized a Social Networking Task Force composed of FINRA staff and industry representatives to discuss how firms and their registered representatives could use social media sites for legitimate business purposes in a manner that ensures investor protection. Based on input from the Task Force and others, and further staff consideration of these issues, FINRA is issuing this *Notice* to guide firms on applying the communications rules to social media sites, such as blogs and social networking sites. The goal of this *Notice* is to ensure that—as the use of social media sites increases over time—investors are protected from false or misleading claims and representations, and firms are able to effectively and appropriately supervise their associated persons' participation in these sites. At the same time, FINRA is seeking to interpret its rules in a flexible manner to allow firms to communicate with clients and investors using this new technology.

While many firms may find that the guidance in this *Notice* is useful when establishing their own procedures, each firm must develop policies and procedures that are best designed to ensure that the firm and its personnel comply with all applicable requirements. Every firm should consider the guidance provided by this *Notice* in the context of its own business and its compliance and supervisory programs.

This *Notice* only addresses the use by a firm or its personnel of social media sites for business purposes. The *Notice* does not purport to address the use by individuals of social media sites for purely personal reasons.

Questions & Answers

Recordkeeping Responsibilities

Q1: Are firms required to retain records of communications related to the broker-dealer's business that are made through social media sites?

A1: Yes. Every firm that intends to communicate, or permit its associated persons to communicate, through social media sites must first ensure that it can retain records of those communications as required by Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 and NASD Rule 3110. SEC and FINRA rules require that for record retention purposes, the content of the communication is determinative and a broker-dealer must retain those electronic communications that relate to its "business as such."[7]

FINRA is aware that some technology providers are developing systems that are intended to enable firms to retain records of communications made through social media sites. Some systems might interface with a firm's network to capture social media participation and feed it into existing systems for the review and retention of email. Other providers are developing technology that might permit a registered representative working off-site to elect to access social media through platforms that will retain the communications on behalf of the firm.

Of course, it is up to each firm to determine whether any particular technology, system or program provides the retention and retrieval functions necessary to comply with the books and records rules. FINRA does not endorse any particular technology necessary to keep such records, nor is it certain that adequate technology currently exists.

Suitability Responsibilities

Q2: If a firm or its personnel recommends a security through a social media site, does this trigger the requirements of NASD Rule 2310 regarding suitability?

A2: Yes. Whether a particular communication constitutes a "recommendation" for purposes of Rule 2310 will depend on the facts and circumstances of the communication. Firms should consult *Notice to Members (NTM) 01-23* (Online Suitability) for additional guidance concerning when an online communication falls within the definition of "recommendation" under Rule 2310.

Various social media sites include functions that make their content widely available or that limit access to one or more individuals. Rule 2310 requires a broker-dealer to determine that a recommendation is suitable for every investor to whom it is made.

Q3: What factors should firms consider when developing procedures for supervising interactive electronic communications on a social media site that recommend specific investment products?

A3: Communications that recommend specific investment products often present greater challenges for a firm's compliance program than other communications. As discussed above, they may trigger the FINRA suitability rule, thus creating possible substantive liability for the firm or a registered representative. These communications must often include additional disclosure in order to provide the customer with a sound basis for evaluating the facts with respect to the product. They also might trigger other requirements under the federal securities laws.[8] FINRA has brought disciplinary actions regarding interactive electronic communications that contained misleading statements about investment products that the communications recommended.[9]

For these reasons, firms must adopt policies and procedures reasonably designed to address communications that recommend specific investment products. As a best practice, firms should consider prohibiting all interactive electronic communications that recommend a specific investment product and any link to such a recommendation unless a registered principal has previously approved the content.

Alternatively, many firms maintain databases of previously approved communications and provide their personnel with routine access to these templates. Firms might consider prohibiting communications that recommend a specific investment product unless the communication conforms to a pre-approved template and the specific recommendation has been approved by a registered principal. Firms also should consider adopting policies and procedures governing communications that promote specific investment products, even if these communications might not constitute a "recommendation" for purposes of our suitability rule or otherwise.

Types of Interactive Electronic Forums

The definition of "public appearance" in NASD Rule 2210 includes unscripted participation in an interactive electronic forum such as a chat room or online seminar. Rule 2210 does not require firms to have a registered principal approve in advance the extemporaneous remarks of personnel who participate in public appearances. However, these interactive electronic forums are subject to other supervisory requirements and to the content requirements of FINRA's communications rule.

Q4: Does a blog constitute an "interactive electronic forum" for purposes of Rule 2210?

A4: The treatment of a blog under Rule 2210 depends on the manner and purposes for which the blog has been constructed. Merriam-Webster's Online Dictionary defines "blog" as "a Web site that contains an online personal journal with reflections, comments, and often hyperlinks provided by the writer."[10] Historically, some blogs have consisted of static content posted by the blogger. FINRA considers static postings to constitute "advertisements" under Rule 2210. If a firm or its registered representative sponsors such a blog, it must obtain prior principal approval of any such posting. Today, however, many blogs enable users to engage in real-time interactive communications. If the blog is used to engage in real-time interactive communications, FINRA would consider the blog to be an interactive electronic forum that does not require prior principal approval; however, such communications must be supervised, as discussed below.[11]

Q5: Social networking sites, such as Facebook, Twitter and LinkedIn, typically include both static content and interactive functions. Are these sites interactive electronic forums for purposes of Rule 2210?

A5: Social networking sites typically contain both static and interactive content. The static content remains posted until it is changed by the firm or individual who established the account on the site. Generally, static content is accessible to all visitors to the site.

Examples of static content typically available through social networking sites include profile, background or wall information. As with other Web-based communications such as banner advertisements, a registered principal of the firm must approve all static content on a page of a social networking site established by the firm or a registered representative before it is posted.[12] Firms may use an electronic system to document these approvals.

Social networking sites also contain non-static, real-time communications, such as interactive posts on sites such as Twitter and Facebook. The portion of a social networking site that provides for these interactive communications constitutes an interactive electronic forum, and firms are not required to have a registered principal approve these communications prior to use. Of course, firms still must supervise these communications, as discussed below.

Supervision of Social Media Sites

Q6: How must firms supervise interactive electronic communications by the firm or its registered representatives using blogs or social networking sites?

A6: The content provisions of FINRA's communications rules apply to interactive electronic communications that the firm or its personnel send through a social media site. While prior principal approval is not required under Rule 2210 for interactive electronic forums, firms must supervise these interactive electronic communications under NASD Rule 3010 in a manner reasonably designed to ensure that they do not violate the content requirements of FINRA's communications rules.[13]

Firms may adopt supervisory procedures similar to those outlined for electronic correspondence in *Regulatory Notice 07-59* (FINRA Guidance Regarding Review and Supervision of Electronic Communications). As set forth in that *Notice*, firms may employ risk-based principles to determine the extent to which the review of incoming, outgoing and internal electronic communications is necessary for the proper supervision of their business.

For example, firms may adopt procedures that require principal review of some or all interactive electronic communications prior to use or may adopt various methods of post-use review, including sampling and lexicon-based search methodologies as discussed in *Regulatory Notice 07-59*. We are aware that technology providers are developing or may have developed systems that are intended to address both the books and records rules and supervisory procedures for social media sites that are similar or equivalent to those currently in use for emails and other electronic communications. FINRA does not endorse any particular technology. Whatever procedures firms adopt, however, must be reasonably designed to ensure that interactive electronic communications do not violate FINRA or SEC rules.

Firms are also reminded that they must have policies and procedures, as described in *Regulatory Notice 07-59*, for the review by a supervisor of employees' incoming, outgoing and internal electronic communications that are of a specific subject matter that require review under FINRA rules and federal securities laws, including:

- NASD Rule 2711(b)(3)(A) and NYSE Rule 472(b)(3), which require that a firm's legal and compliance department be copied on communications between non-research and research departments concerning the content of a research report;
- NASD Rule 3070(c) and NYSE Rule 351(d), which require the identification and reporting of customer complaints; NYSE Rule 401A requires that the receipt of each complaint be acknowledged by the firm to the customer within 15 business days; and

- NASD Rule 3110(j) and NYSE Rule 410, which require the identification and prior written approval of every order error and other account designation change.

Q7: What restrictions should firms place on which personnel may establish an account with a social media site?

A7: Firms must adopt policies and procedures reasonably designed to ensure that their associated persons who participate in social media sites for business purposes are appropriately supervised, have the necessary training and background to engage in such activities, and do not present undue risks to investors. Firms must have a general policy prohibiting any associated person from engaging in business communications in a social media site that is not subject to the firm's supervision. Firms also must require that only those associated persons who have received appropriate training on the firm's policies and procedures regarding interactive electronic communications may engage in such communications.

As firms develop their policies, they should consider prohibiting or placing restrictions on any associated person who has presented compliance risks in the past, particularly compliance risks concerning sales practices, from establishing accounts for business purposes with a social media site. In its supervision of social networking sites, each firm must monitor the extent to which associated persons are complying with the firm's policies and procedures governing the use of these sites. Firms also should consider policies that address associated persons' continued use of such sites if the firm's supervisory systems demonstrate compliance risks. Firms should take disciplinary action if the firm's policies are violated.

Third-Party Posts

Q8: If a customer or other third party posts content on a social media site established by the firm or its personnel, does FINRA consider the third-party content to be the firm's communication with the public under Rule 2210?

A8: As a general matter, FINRA does not treat posts by customers or other third parties as the firm's communication with the public subject to Rule 2210. Thus, the prior principal approval, content and filing requirements of Rule 2210 do not apply to these posts.

Under certain circumstances, however, third-party posts may become attributable to the firm. Whether third-party content is attributable to a firm depends on whether the firm has (1) involved itself in the preparation of the content or (2) explicitly or implicitly endorsed or approved the content.

The SEC has referred to circumstance (1) above as the "entanglement" theory (*i.e.*, the firm or its personnel is entangled with the preparation of the third-party post) and (2) as the "adoption" theory (*i.e.*, the firm or its personnel has adopted its content).[14] Although the SEC has employed these theories as a basis for a company's responsibility for third-party information that is hyperlinked to its Web site, a similar analysis would apply to third-party posts on a social media site established by the firm or its personnel.

For example, FINRA would consider such a third-party post to be a communication with the public by the firm or its personnel under the entanglement theory if the firm or its personnel paid for or otherwise was involved with the preparation of the content prior to posting. FINRA also would consider a third-party post to be a communication with the public by the firm or its personnel under the adoption theory if, after the content is posted, the firm or its personnel explicitly or implicitly endorses or approves the post.[15]

Q9: Must a firm also use a disclaimer to inform customers that third-party posts do not reflect the views of the firm and have not been reviewed by the firm for completeness or accuracy?

A9: Assuming the disclaimer was sufficiently prominent to inform investors of the firm's position, such a disclaimer would be part of the facts and circumstances that FINRA would consider in an analysis of whether a firm had adopted or become entangled with a posting.

Q10: Must a firm monitor third-party posts?

A10: FINRA does not consider a third-party post to be a firm communication with the public unless the firm or its personnel either is entangled with the preparation of the third-party post or has adopted its content. Nevertheless, FINRA has found through its discussions with members of the Social Networking Task Force and others that many firms monitor third-party posts on firm Web sites. For example, some firms monitor third-party posts to mitigate the perception that the firm is adopting a third-party post, to address copyright issues or to assist compliance with the "Good Samaritan" safe harbor for blocking and screening offensive material under the Communications Decency Act.[16]

Some of the other best practices adopted by Task Force members include:

- establishing appropriate usage guidelines for customers and other third parties that are permitted to post on firm-sponsored Web sites;
- establishing processes for screening third-party content based on the expected usage and frequency of third-party posts; and
- disclosing firm policies regarding its responsibility for third-party posts.

Endnotes

1 *See* Amanda Lenhart, Pew Internet and American Life Project, *The Democratization of Online Social Networks* (Oct. 8, 2009), *http://fe01.pewinternet.org/Presentations/2009/41--The-Democratization-of-Online-Social-Networks.aspx*.

2 Sharon Gaudin, *Business Use of Facebook, Twitter Exploding*, Computerworld (Nov. 9, 2009), at *www.computerworld.com/s/article/9140579/Business_use_of_Twitter_Facebook_exploding*.

3 *See* "Ask the Analyst – Electronic Communications," NASD Regulation, *Regulatory & Compliance Alert* (Mar. 1999) ("March 1999 Ask the Analyst").

4 *See* NASD Rule 2210(a)(5).

5 *See Guide to the Internet for Registered Representatives*, at *www.finra.org/Industry/Issues/Advertising/p006118*.

6 *See* "Electronic Communications: Blogs, Bulletin Boards and Chat Rooms" (Feb. 23, 2009), and "Electronic Communications: Social Networking Web Sites" (Mar. 10, 2009) at *www.finra.org/podcasts*.

FINRA is also hosting webinars on compliance considerations for social networking sites on February 3 and March 17, 2010. Find more information at *www.finra.org/webinars*.

7 *See*, SEC Rel. No. 34-37182 (May 9, 1996), 61 Fed. Reg. 24644 (May 15, 1996); SEC Rel. No. 34-38245 (Feb. 5, 1997), 62 Fed. Reg. 6469 (Feb. 12, 1997); *Notice to Members 03-33* (July 2003).

8 For example, even if FINRA considers a communication made through an interactive electronic forum to be a public appearance, the SEC staff could still conclude that Rule 482 under the Securities Act of 1933 and the filing requirements of Section 24(b) of the Investment Company Act of 1940 apply to the communication. Accordingly, firms must consider these requirements in determining whether to permit interactive electronic communications that discuss registered investment companies.

9 For example, in a Default Decision dated November 23, 2009, FINRA fined and suspended a registered principal who held put options for himself and issued unapproved bulletin board messages that urged investors to sell the underlying stock. The bulletin board messages omitted material disclosure regarding his interest in the stock.

10 Merriam-Webster's Online Dictionary, definition of "blog," at *http://www.merriam-webster.com/dictionary/BLOG*.

11 The key to this distinction between whether a blog is considered an advertisement versus an interactive electronic forum is whether it is used to engage in real-time interactive communications with third parties. Thus, the mere updating of a non-interactive blog (or any other firm Web page) does not cause it to become an interactive electronic forum, even if the updating occurs frequently.

12 Currently, NASD Rule 2210(b) requires that a registered principal of a firm approve all advertisements and sales literature prior to use either electronically or in writing. FINRA has proposed amendments to this rule. These amendments would retain this prior to use principal approval requirement for "retail communications" as defined in the proposal. *See Regulatory Notice 09-55* (Sept. 2009).

Endnotes Continued

13 *See, e.g.,* March 1999 Ask the Analyst, *supra* note 3.

14 *See Commission Guidance on the Use of Company Web Sites,* SEC Rel. No. 34-58288 (Aug. 1, 2008), 73 Fed. Reg. 45862, 45870 (Aug. 7, 2008) ("2008 SEC Release"); *Use of Electronic Media,* SEC Rel. No. 33-7856 (April 28, 2000), 65 Fed. Reg. 25843, 25848-25849 (May 4, 2000).

15 *See* 2008 SEC Release, *supra* note 14, 65 Fed. Reg. 45870 n.78.

16 *See* 47 U.S.C. § 230(c).

Regulatory Notice 11-39

Social Media Websites and the Use of Personal Devices for Business Communications

Guidance on Social Networking Websites and Business Communications

Executive Summary

In January 2010, FINRA issued *Regulatory Notice 10-06*, providing guidance on the application of FINRA rules governing communications with the public to social media sites and reminding firms of the recordkeeping, suitability, supervision and content requirements for such communications. Since its publication, firms have raised additional questions regarding the application of the rules. This *Notice* responds to these questions by providing further clarification concerning application of the rules to new technologies. It is not intended to alter the principles or the guidance provided in *Regulatory Notice 10-06*.

Questions concerning this *Notice* may be directed to:

- Joseph E. Price, Senior Vice President, Advertising Regulation/Corporate Financing, at (240) 386-4623;
- Thomas A. Pappas, Vice President, Advertising Regulation, at (240) 386-4553; or
- Amy Sochard, Director, Advertising Regulation, at (240) 386-4508.

August 2011

Notice type:
- Guidance

Suggested Routing
- Advertising
- Compliance
- Legal
- Operations
- Registered Representative
- Senior Management

Key Topics
- Communications With the Public
- Personal Electronic Devices
- Recordkeeping
- Social Networking Websites
- Supervision

Referenced Rules & Notices
- NASD Rule 2210
- NASD Rule 2211
- NASD Rule 3010
- FINRA Rule 4511
- NTM 05-48
- Regulatory Notice 08-77
- Regulatory Notice 10-06
- Regulatory Notice 11-14
- SEA Rule 17a-3
- SEA Rule 17a-4

FINRA
Financial Industry Regulatory Authority

Background

1. Recordkeeping

The obligations of a firm to keep records of communications made through social media depend on whether the content of the communication constitutes a business communication. Rule 17a-4(b) under the Securities Exchange Act of 1934 (SEA) requires broker-dealers to preserve certain records for a period of not less than three years, the first two in an easily accessible place.[1] Among these records, pursuant to SEA Rule 17a-4(b)(4), are "[o]riginals of all communications received and copies of all communications sent (and any approvals thereof) by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of a self-regulatory organization of which the member, broker or dealer is a member regarding communications with the public."[2] The SEC has stated that the content of an electronic communication determines whether it must be preserved.[3]

2. Supervision

NASD Rule 3010 requires each firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable federal securities laws and FINRA rules. As part of this responsibility, a registered principal must review prior to use any social media site that an associated person intends to employ for a business purpose. The registered principal may approve use of the site for a business purpose only if the registered principal has determined that the associated person can and will comply with all applicable FINRA rules, the federal securities laws, including recordkeeping requirements, and any additional requirements established by the firm.

The registered principal must review an associated person's proposed social media site in the form in which it will be "launched." Some firms require a registered principal to review the first posting by an associated person on an interactive forum within the site. This approach can help to ensure that the registered principal will be reviewing not only the initial communication, but the social media site itself in its completed design.

FINRA considers unscripted participation in an interactive electronic forum to come within the definition of "public appearance" under NASD Rule 2210. Public appearances do not require prior approval by a registered principal. Firms may adopt risk-based supervisory procedures utilizing post-use review, including sampling and lexicon-based search methodologies, of unscripted participation in an interactive electronic forum. The procedures a firm adopts must be reasonably designed to ensure that interactive electronic communications do not violate FINRA or SEC rules, including the content requirements of NASD Rule 2210, such as the prohibition on misleading statements or claims and the requirement that communications be fair and balanced. A static posting is deemed an "advertisement" under NASD Rule 2210 and therefore requires a registered principal to approve the posting prior to use.[4]

3. Links to Third-Party Sites

Firms may not establish a link to any third-party site that the firm knows or has reason to know contains false or misleading content. A firm should not include a link on its website if there are any red flags that indicate the linked site contains false or misleading content. Additionally, a firm is responsible under NASD Rule 2210 for content on a linked third-party site if the firm has adopted or has become entangled with its content. For example, a firm may be deemed to have "adopted" third-party content if it indicates on its site that it endorses the content on the third-party site. A firm could be deemed to have become "entangled" with a third-party site if, for example, it participates in the development of the content on the third-party site.

4. Data Feeds

Firms must adopt procedures to manage data feeds into their own websites. FINRA is aware of situations in which firms have received data feeds that were inaccurate. Firms must be familiar with the proficiency of the vendor of the data and its ability to provide data that is accurate as of the time it is presented on the firm's website. Firms also must understand the criteria followed by vendors in gathering or calculating the types of data that the firm intends to feed into its website, in order to determine whether the vendor is performing this function in a reasonable manner.[5] Firms also should regularly review aspects of these data feeds for any red flags that indicate that the data may not be accurate, and should promptly take necessary measures to correct any inaccurate data.

Questions & Answers

Recordkeeping

Q1: Does determining whether a communication is subject to the recordkeeping requirements of SEA Rule 17a-4(b)(4) depend on whether an associated person uses a personal device or technology to make the communication?

A1: SEA Rule 17a-4(b)(4) requires a firm to retain records of communications that relate to its "business as such." Whether a particular communication is related to the business of the firm depends upon the facts and circumstances. This analysis does not depend upon the type of device or technology used to transmit the communication, nor does it depend upon whether it is a firm-issued or personal device of the individual; rather, the content of the communication is determinative. For instance, the requirement would apply if the electronic communication was received or sent by an associated person through a third-party's platform or system. A firm's policies and procedures must include training and education of its associated persons regarding the differences between business and non-business communications and the measures required to ensure that any business communication made by associated persons is retained, retrievable and supervised.

Q2: When an associated person posts autobiographical information, such as place of employment or job responsibilities, does this information constitute a business communication?

A2: As discussed in question 1 above, firms must develop policies and procedures that include training regarding the difference between business and non-business communications to enable appropriate compliance. In certain contexts, such as sending a resume to a potential employer, the communication could be viewed as not relevant to the business of the firm. In other contexts, such as posting a list of products or services offered by the firm, the communication likely will be viewed as a business communication.

Q3: May a firm or associated person sponsor a social media site or use a communication device that includes technology which automatically erases or deletes the content?

A3: No. Technology that automatically erases or deletes the content of an electronic communication would preclude the ability of the firm to retain the communications in compliance with their obligations under SEA Rule 17a-4. Accordingly, firms and associated persons may not sponsor such sites or use such devices.

Q4: Do the recordkeeping requirements apply to third-party posts to a firm or an associated person's social media sites if the firm or the individual has not adopted or become entangled with the post?

A4: *Regulatory Notice 10-06* addresses the application of NASD Rule 2210 to third-party posts on a social media site established by a firm or its associated persons. Unless the firm or its associated persons have adopted or become entangled with the post, FINRA generally does not treat third-party posts as the firm's or its associated persons' communications under the rule. The recordkeeping requirements, however, require retention of the records of all communications received by a firm or its associated persons relating to its business as such.

Q5: Do the recordkeeping requirements differ for static and interactive communications?

A5: They do not—the recordkeeping requirements are governed by the content of the communication. As noted above, the FINRA *supervision* requirements differ for static and interactive communications.

Supervision

Q6: Can interactive content become static?

A6: Yes. For example, interactive content could be copied or forwarded and posted in a static forum, such as a blog or static area of a Web page, in a manner that renders it static content. It then would constitute an advertisment under NASD Rule 2210, requiring prior approval by a registered principal of the firm.

Q7: What measures should a firm adopt to monitor compliance with its social media policies?

A7: A firm must conduct appropriate training and education concerning its policies, including those relating to social media. Firms must follow up on "red flags" that may indicate that an associated person is not complying with firm policies. Some firms require each associated person to certify on an annual or more frequent basis that the associated person is acting in a manner consistent with such policies. When feasible, some firms also have chosen to randomly spot check websites to help them monitor compliance with firm policies.

Q8: Must material changes to static content posted by a firm or its associated persons on a social media site that contains business communications receive prior approval by a registered principal?

A8: NASD Rule 2210(1)(b) requires a registered principal to approve each advertisement and item of sales literature before the earlier of its use or filing with FINRA's Advertising Regulation Department. NASD Rule 2210(c)(8) excludes from the filing requirements any advertisement or sales literature that previously had been filed and that is to be used "without material change." Firms are expected to adopt procedures requiring prior registered principal approval of any advertisement or sales literature that has been materially changed, even if it had been previously approved in an earlier version. For example, changes in the description of the advantages of investing in the advertised product or of its risks would typically require registered principal prior approval. Since static content posted by a firm or its associated persons on a social media site that contains business communications is considered to be an advertisement, these procedures must apply to such static content.

Third-Party Posts, Third-Party Links and Websites

Q9: If a third party posts a business-related communication, such as a question about a security, on an associated person's personal social media site, may the associated person respond to the communication?

A9: Yes, provided that the response does not violate the firm's policies concerning participation on a personal social media site. If a firm has a policy that associated persons may not use a personal social media site for business purposes, then a substantive response by the associated person would violate this policy.[6] Some firms permit a non-substantive response, and pre-approve statements that their associated persons may make to respond to such posts and that direct the third party to other firm-approved communication media, such as the firm's email system.

Q10: To what extent is a firm responsible for any third-party website that the firm or its associated person "co-brands"?

A10: Under NASD Rule 2210, a firm that co-brands any part of a third-party site, such as by placing the firm's logo prominently on the site, is responsible for the content of the entire site. Under these circumstances, FINRA considers the firm to have adopted the content on that site. A firm is responsible under NASD Rule 2210 for content on a linked third-party site if the firm has adopted or become entangled with its content. *Regulatory Notice 10-06* describes the "adoption" and "entanglement" theories as they apply to third-party posts on a firm's social media sites. FINRA considers a firm to have adopted content in a third-party post if the firm or its personnel explicitly or implicitly endorse or approve the post.

Q11: When is a firm *not* responsible for the content on a third-party site to which it links?

A11: A firm may establish a link to the site of an independent third party without assuming responsibility for the content of that site under NASD Rule 2210 if:

- the firm does not "adopt" or become "entangled" with the content of the third-party site; and
- the firm does not know or have reason to know that the site contains false or misleading information.

Q12: If firm policy requires deletion of inappropriate third-party content, will the firm be considered to have adopted any third-party posts that are not deleted?

A12: No. The fact that the firm has a policy of routinely blocking or deleting certain types of content in order to ensure the content is appropriate would not mean that the firm had adopted the content of the posts left on the site. For example, most firms using social media sites block or screen offensive material. Such a policy would not indicate that the firm has adopted the remaining third-party content.

Q13: Does NASD Rule 2210 require firms to approve or maintain records of statistical information that the firm has regularly updated on its website?

A13: NASD Rule 2210(b)(1) requires that a registered principal approve each advertisement and item of sales literature prior to use or filing with FINRA's Advertising Regulation Department. NASD Rule 2210(b)(2) requires firms to maintain all advertisements and sales literature, including the names of the persons who prepared them or approved their use, for a period beginning on the date of first use and ending three years from the date of last use.

Statistical information that is posted on a firm's website would be considered an "advertisement" subject to the approval and recordkeeping requirements of NASD Rules 2210(b)(1) and (2). However, some firms establish templates for the presentation of this data, and subject these templates to those provisions. The data that is fed into the website in accordance with such a template would not be subject to the requirements of NASD Rules 2210(b)(1) and (2). The firm must have procedures reasonably designed to ensure that the data can be verified to ensure that it is timely and accurate, and that the firm can promptly correct data that is erroneous when posted or becomes inaccurate over time.

Accessing Social Media Sites From Personal Devices

Q14: May associated persons use personal communication devices and other equipment, such as a smart phone or tablet computer, to access firm business applications and perform business activity if the firm employs technology that enables the firm to keep records and supervise the activity?

A14: Yes. Firms may permit their associated persons to use any personal communication device, whether it is owned by the associated person or the firm, for business communications. FINRA recognizes that the development of new technologies can facilitate the ability of associated persons to perform their responsibilties and, in the case of registered representatives, to serve their clients. Of course, the firm must be able to retain, retrieve and supervise business communications regardless of whether they are conducted from a device owned by the firm or by the associated person.

In order to ensure that the business communications are readily retrievable without necessitating the capture of personal communications made on the same device, firms should have the ability to separate business and personal communications, such as by requiring that the associated persons use a separately identifiable application on the device for their business communications. If possible, this application should provide a secure portal into the firm's own communication system, particularly if confidential customer information may be shared. If the firm has the ability to separate business and personal communications, and has adequate electronic communications policies and procedures regarding usage, then the firm is not required to supervise the personal emails made on these devices. Of course, firms also are free to treat all communications made through the personal communication device as business communications.

Endnotes

1. SEA Rule 17a-4(f) permits broker-dealers to maintain and preserve these records on "micrographic media" or by means of "electronic storage media," as defined in the rule and subject to a number of conditions.
2. *See also* NASD Rule 2210(b)(2) (requiring the retention of all advertisements, sales literature and independently prepared reprints), NASD Rule 2211(b)(2) (requiring the retention of institutional sales material) and NASD Rule 3010(d)(3) (requiring the retention of correspondence of registered representatives).
3. *See* Reporting Requirements for Brokers or Dealers under the Securities Exchange Act of 1934, SEC Rel. No. 34-38245 (Feb. 5, 1997).
4. FINRA has filed with the SEC a proposed rule change that would replace most of the NASD and NYSE rules governing communications with the public with a series of new FINRA rules. *See* SR-FINRA-2011-035. Among other changes, the term "advertisement" would be subsumed within a new communication category, "retail communication."
5. *Cf.*, *Regulatory Notice 08-77* (Dec. 2008) (Customer Account Statements) (discussion of "data vendors"). *See also* *Notice to Members (NTM) 05-48* (July 2005) (Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers); *Regulatory Notice 11-14* (March 2011) (FINRA Requests Comment on Proposed New FINRA Rule 3190 to Clarify the Scope of a Firm's Obligations and Supervisory Responsibilities for Functions or Activities Outsourced to a Third-Party Service Provider).
6. Of course, if the firm permits business-related communications on a personal social media site, then the firm must supervise that site for compliance with applicable rules and the federal securities laws.

IM Guidance Update

March 2014 | No. 2014-4

GUIDANCE ON THE TESTIMONIAL RULE AND SOCIAL MEDIA

From time to time, we have been asked questions concerning the nature, scope and application of the rule that prohibits investment advisers from using testimonials in their advertisements. In addition, in the past several years, we have been asked a number of questions concerning investment advisers' use of social media. We are now providing this guidance concerning registered investment advisers' use of social media and their publication[1] of advertisements that feature public commentary about them that appears on independent, third-party social media sites.[2]

We understand that use of social media has increased the demand by consumers for independent, third-party commentary or review of any manner of service providers, including investment advisers. We recognize that social media has facilitated consumers' ability to research and conduct their own due diligence on current or prospective service providers. Through this guidance, we seek to clarify application of the testimonial rule as it relates to the dissemination of genuine third-party commentary that could be useful to consumers.

Specifically, we seek through this guidance to assist firms in applying section 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and rule 206(4)-1(a)(1) thereunder ("testimonial rule") to their use of social media.[3] The guidance, in the form of questions and answers, also seeks to assist investment advisers in developing compliance policies and procedures reasonably designed to address participation in this evolving technology, specifically with respect to the publication of any public commentary that is a testimonial.

Consistent with previous staff guidance, we believe that in certain circumstances, as described below, an investment adviser's or investment advisory representative's ("IAR's") publication of <u>all</u> of the testimonials about the investment adviser or IAR from an independent social media site on the investment adviser's or IAR's own social media site or website would not implicate the concern underlying the testimonial rule.[4]

US Securities and Exchange Commission
Division of Investment Management

BACKGROUND

Section 206(4) generally prohibits any investment adviser from engaging in any act, practice or course of business that the Commission, by rule, defines as fraudulent, deceptive or manipulative. In particular, rule 206(4)-1(a)(1) states that:

> *[i]t shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business . . . for any investment adviser registered or required to be registered under [the Advisers Act], directly or indirectly, to publish, circulate, or distribute any advertisement which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser.*

Rule 206(4)-1(a)(1) was designed to address the nature of testimonials when used in investment advisory advertisements. When it adopted the rule, the Commission stated that, in the context of investment advisers, it found ". . . such advertisements are misleading; by their very nature they emphasize the comments and activities favorable to the investment adviser and ignore those which are unfavorable."[5] The staff has stated that the rule forbids the use of a testimonial by an investment adviser in advertisements "because the testimonial may give rise to a fraudulent or deceptive implication, or mistaken inference, that the experience of the person giving the testimonial is typical of the experience of the adviser's clients."[6]

Whether public commentary on a social media site is a testimonial depends upon all of the facts and circumstances relating to the statement. The term "testimonial" is not defined in the rule, but the staff has consistently interpreted that term to include a "statement of a client's experience with, or endorsement of, an investment adviser."[7] Depending on the facts and circumstances, public commentary made directly by a client about his or her own experience with, or endorsement of, an investment adviser or a statement made by a third party about a client's experience with, or endorsement of, an investment adviser may be a testimonial.[8]

The staff also has stated that an investment adviser's publication of an article by an unbiased third party regarding the adviser's investment performance is not a testimonial, unless it includes a statement of a client's experience with or endorsement of the adviser.[9] The staff also has stated that an adviser's advertisement that includes a partial client list that does no more than identify certain clients of the adviser cannot be viewed either as a statement of a client's experience with, or endorsement of, the adviser and therefore is not a testimonial.[10] Such an advertisement could nonetheless violate section 206(4) and rule 206(4)-1(a)(5) if the advertisement is false or misleading.[11]

The staff no longer takes the position, as it did a number of years ago, that an advertisement that contains non-investment related commentary regarding an IAR, such as regarding an IAR's religious affiliation or community service, may be deemed a testimonial violative of rule 206(4)-1(a)(1).[12]

The following questions and answers are intended to provide more guidance.

Third-party commentary

Q1. *May an investment adviser or IAR publish public commentary that is an explicit or implicit statement of a client's experience with or endorsement of the investment adviser or IAR on the investment adviser's or IAR's social media site?*

A1. Generally, staff believes that such public commentary would be a testimonial within the meaning of rule 206(4)-1(a)(1) and its use in an advertisement by an investment adviser or IAR would therefore be prohibited.

- For example, if an investment adviser or IAR invited clients to post such public commentary directly on the investment adviser's own internet site, blog or social media site that served as an advertisement for the investment adviser or IAR's advisory services, such testimonials would not be permissible.

Q2. *May an investment adviser or IAR publish the same public commentary on its own internet or social media site if it comes from an independent social media site?*

A2. When an investment adviser or IAR has no ability to affect which public commentary is included or how the public commentary is presented on an independent social media site; where the commentators' ability to include the public commentary is not restricted;[13] and where the independent social media site allows for the viewing of all public commentary and updating of new commentary on a real-time basis, the concerns underlying the testimonial prohibition may not be implicated.

As described in more depth below, publication of public commentary from an independent social media site would not raise any of the dangers that rule 206(4)-1(a)(1) was designed to prevent if:

- the independent social media site provides content that is independent of the investment adviser or IAR;
- there is no material connection between the independent social media site and the investment adviser or IAR that would call into question the independence of the independent social media site or commentary; and

- the investment adviser or IAR publishes all of the unedited comments appearing on the independent social media site regarding the investment adviser or IAR.[14]

Under these circumstances, an investment adviser or IAR may include such public commentary in an advertisement without implicating the concerns underlying the testimonial rule.

If, however, the investment adviser or IAR drafts or submits commentary that is included on the independent social media site, the testimonial rule generally would be implicated. Also, if the investment adviser or IAR is allowed to suppress the publication of all or a portion of the commentary, edit the commentary or is able to organize or prioritize the order in which the commentary is presented, the testimonial rule generally would be implicated.

Q3. *What content is not independent of an investment adviser or IAR and what is a material connection that would call into question the independence of a site or commentary?*

A3. Commentary would not be independent of an investment adviser or IAR if the investment adviser or IAR directly or indirectly authored the commentary on the independent social media site, whether in their own name, a third party's name, or an alias, assumed or screen name.

An investment adviser or IAR would have a material connection with a site or commentary that would call into question the independence of the site or commentary if, for example, the investment adviser or IAR: (1) compensated a social media user for authoring the commentary, including with any product or service of value; or (2) prioritized, removed or edited the commentary.[15]

- For example, an investment adviser could not have a supervised person submit testimonials about the investment adviser on an independent social media site and use such testimonials in advertisements without implicating the testimonial rule.

- An investment adviser or IAR could not compensate a client or prospective client (including with discounts or offers of free services) to post commentary on an independent social media site and use such testimonials in advertisements without implicating the testimonial rule.

Q4. *May an investment adviser or IAR publish testimonials from an independent social media site in a way that allows social media users to sort the criteria?*

A4. An investment adviser or IAR's publication of testimonials from an independent social media site that directly or indirectly emphasizes commentary favorable to the investment adviser or IAR or de-emphasizes commentary unfavorable to the investment adviser or IAR would implicate the prohibition on testimonials. The investment adviser may publish only the totality of the testimonials from an independent social media site and may not highlight or give prominence to a subset of the testimonials.

- Investment adviser or IAR sites may publish the testimonials from an independent social media site in a content-neutral manner, such as by chronological or alphabetical order, which presents positive and negative commentary with equal prominence.

- Social media users, however, are free to personally display the commentary and sort by any criteria, including by the lowest or highest rating. Investment adviser and IAR sites may facilitate a user's viewing of the commentary by providing a sorting mechanism as long as the investment adviser or IAR site does not itself sort the commentary.

Q5. *May an investment adviser or IAR publish testimonials from an independent social media site that includes a mathematical average of the public commentary?*

A5. Publication by an investment adviser or IAR of such testimonials from an independent social media site would not raise any of the dangers that rule 206(4)-1(a)(1) was designed to prevent if the independent social media site were designed to make it equally easy for the public to provide negative or positive commentary about an investment adviser or IAR.

- Investment advisers or IARs could publish testimonials from an independent social media site that include a mathematical average of the commentary provided that commenters themselves rate the investment advisers or IARs based on a ratings system that is not designed to elicit any pre-determined results that could benefit any investment adviser or IAR.

- The independent social media site, the investment adviser and the IAR may not provide a subjective analysis of the commentary.[16]

Inclusion of on Investment Adviser Advertisements on Independent Social Media Site

Q6. *May an investment adviser or IAR publish public commentary from an independent site if that site also features the investment adviser or IAR's advertising?*

A6. The existence of an investment adviser or IAR's advertisement within the architecture of an independent site that also contains independent public commentary does not, in combination, create a prohibited testimonial or otherwise make the advertisement false or misleading, provided that the investment adviser complies with the material connection and independence factors described above and provided that the advertisement is easily recognizable to the public as a sponsored statement.

- In other words, an advertisement would not cause the investment adviser or IAR's publication of the independent social media site's commentary to violate rule 206(4)-1 where (1) it would be readily apparent to a reader that the investment adviser or IAR's advertisement is separate from the public commentary featured on the independent social media site and (2) the receipt or non-receipt of advertising revenue did not in any way influence which public commentary is included or excluded from the independent social media site.

Reference to Independent Social Media Site Commentary Investment Adviser Non-Social Media Advertisements

Q7. *May an investment adviser or IAR refer to public commentary from an independent social media site on non-social media advertisements* (*e.g.*, newspaper, radio, television)*?*

A7. An investment adviser or IAR could reference the fact that public commentary regarding the investment adviser or IAR may be found on an independent social media site, and may include the logo of the independent social media site on its non-social media advertisements, without implicating the testimonial rule.

- For example, an IAR could state in its newspaper ad "see us on [independent social media site]," to signal to clients and prospective clients that they can research public commentary about the investment adviser or IAR on an independent social media site.

- In contrast, an investment adviser or IAR may not publish any testimonials from the independent social media site on the newspaper ad without implicating the testimonial rule.[17]

Client lists

Q8. Would a list or photographs of "friends" "or "contacts" on an investment adviser or IAR's social media site that is viewable by the general public be considered a testimonial or otherwise violate section 206(4) or rule 206(4)-1?

A8. It is common on social media sites to include a communal listing of contacts or friends. The staff has stated that an advertisement that contains a partial client list that does no more than identify certain clients of the adviser cannot be viewed either as a statement of a client's experience with, or endorsement of, the investment adviser, and therefore is not a testimonial.[18] Such an advertisement, however, could be false or misleading under rule 206(4)-1(a)(5) depending on the facts and circumstances.

- If the contacts or friends are not grouped or listed so as to be identified as current or past clients of an IAR, but are simply listed by the social media site as accepted contacts or friends of the IAR in the ordinary course, such a listing of contacts or friends generally would not be considered to be in violation of rule 206(4)-1(a)(1).

- However, if an IAR attempts to create the inference that the contacts or friends have experienced favorable results from the IAR's investment advisory services, the advertisement could be considered to be in violation of section 206(4) and rule 206(4)-1.

Fan/Community Pages

Q9. Individuals unconnected with a particular investment adviser or IAR may establish "community" or "fan" or other third-party sites where the public may comment on a myriad of investment topics, along with commentary regarding an investment adviser firm or individual IARs. Do such sites raise concerns under rule 206(4)-1?

A9. In the ordinary course, a third party's creation and operation of unconnected community or fan pages generally would not implicate rule 206(4)-1. We strongly caution investment advisers and supervised persons when publishing content from or driving user traffic to such sites (including through hyperlinks to such sites), particularly if the site does not meet the material connection and independence conditions described above. The Commission has stated that:

> *any SEC-registered investment adviser (or investment adviser that is required to be SEC registered) that includes, in its web site or in other electronic communications, a hyperlink to postings on third-party web sites, should carefully consider the applicability of the advertising provisions of the [Advisers Act]. Under the Advisers Act, it is a fraudulent act for an investment adviser to, among other things, refer to testimonials in its advertisements.*[19]

Endnotes

1 For purposes of this guidance, "publication" refers to any form of real-time broadcast through social media or the Internet whether by hyperlinking, posting, live-streaming, tweeting, or forwarding or any similar public dissemination and, does not relate to advertisements on non-Internet or non-social media sites, such as paper, television or radio. Social media allows for instantaneous updating of posted commentary and concurrent viewing of *all of* the comment history; in contrast, paper, television and radio are static media that reflect public commentary at a particular point in time and are limited media that would typically not reproduce all of the available public commentary simultaneously (often due to cost, space and other considerations).

2 As used herein, "independent social media sites" refers specifically to third-party social media sites that predominantly host user opinions, beliefs, findings or experiences about service providers, including investment advisory representatives or investment advisers (*e.g.*, Angie's List). An investment adviser's or IAR's own social media profile or account that is used for business purposes is not an "independent social media site."

3 This *IM Guidance Update* only addresses the use by a firm or IARs of social media sites for business purposes. This Update does not address the use by individuals of social media sites for purely personal reasons. This Update does not seek to address any obligations under state law of social media for business use. In addition, this guidance does not seek to address the use of social media sites by broker-dealers.

4 Any such advertisements also must comply with rule 206(4)-1(a)(5).

5 Investment Advisers Act Rel. No. 121 (Nov. 2, 1961) (adopting rule 206(4)-1).

6 *See* Richard Silverman, Staff No-Action Letter (pub. avail. March 27, 1985).

7 *See* Cambiar Investors, Inc., Staff No-Action Letter (pub. avail. Aug. 28, 1997) ("Cambiar").

8 *See* DALBAR, Inc., Staff No-Action letter (pub. avail. March 24, 1998) ("DALBAR").

9 *See* New York Investors Group, Inc., Staff No-Action Letter (pub. avail. Sept. 7, 1982); Stalker Advisory Services, Staff No-Action Letter (pub. avail. Feb. 14, 1994). *See also* Kurtz Capital Management, Staff No-Action Letter (pub. avail. Jan. 22, 1988).

10 *See* Cambiar, supra note 7.

11 *Id.* ("For example, the inclusion of a partial client list in an adviser's advertisement has the potential to mislead investors if the clients on the list are selected on the basis of performance and this selection bias is not adequately disclosed. A list that includes only advisory clients who have experienced above-average performance could lead an investor who contacts the clients for references to infer something about the adviser's competence or about the possibility of enjoying a similar investment experience that the investor might not have inferred if criteria unrelated to the client's performance had been used to select the clients on the list or if the selection bias was fully and fairly disclosed.").

12 *See* Dan Gallagher, Staff No-Action Letter (pub. avail. July 10, 1995). Advisers that publish advertisements regarding non-investment related commentary remain subject to the fiduciary responsibilities imposed by section 206(1) and (2) of the Advisers Act. Thus an adviser cannot use social media to perpetrate affinity frauds, which are investment scams that prey upon members of identifiable groups, such as religious or ethnic communities, the elderly, or professional groups. Affinity frauds can target any group of people who take pride in their shared characteristics, whether they are religious, ethnic, or professional. *See* http://www.sec.gov/investor/pubs/affinity.htm.

13 Some independent social media sites may have member fees or subscriptions payable by users. An investment adviser or IAR's publication of public commentary from a site that charges member or subscription fees to public users would not call into question the independence of the independent social media site for purposes of our views herein.

14 Independent social media sites may have editorial policies that edit or remove public commentary violative of the site's own published content guidelines (*e.g.*, prohibiting defamatory statements; threatening language; materials that infringe on intellectual property rights; materials that contain viruses, spam or other harmful components; racially offensive statements or profanity). An investment adviser or IAR's publication of public commentary that has been edited according to such an editorial policy would not call into question the independence of the independent social media site for purposes of the staff's views herein.

15 As explained in Q6 below, any arrangement whereby the investment adviser or IAR compensated the independent social media site, including with advertising or other revenue, in order to publish or suppress the publication of anything less than the totality of the public commentary submitted could render any use by the IAR or investment adviser on its social media site violative of the prohibition on testimonials.

16 *See* DALBAR, supra note 8.

17 *See* supra note 1.

18 *See Cambiar, supra* note 7.

19 *See* Commission Guidance on the Use of Company Websites at note 83, Investment Company Act Rel. No. 28351 (Aug. 1, 2008). *See also SEC Interpretation: Use of Electronic Media*, Investment Company Act Rel. No. 24426 (May 4, 2000).

This *IM Guidance Update* summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This *IM Guidance Update* is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this *IM Guidance Update*.

The Investment Management Division works to:

- protect investors
- promote informed investment decisions and
- facilitate appropriate innovation in investment products and services

through regulating the asset management industry.

If you have any questions about this IM Guidance Update, please contact:

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How to use the cloud securely (because it's not going away)

Like anything you do for your business, don't do it just to keep pace. Make it a determined decision that will either save you time, money or both.

By Blane Warrene | *August 18, 2014 - 1:42 pm EST*

You can't have a business conversation or attend an industry conference without hearing someone ask "are you in the cloud?" Indeed, servers and disk storage have been evolving frighteningly quickly over the past five years.

However, like anything you do for your business, don't do it just to keep pace. Make it a determined decision that means you will either save time, money or both. And if you can add in offering new capabilities for your clients, all the better.

You can embrace the cloud in a meaningful way.

Chances are most of you have already, most likely in the form of an app powering your business operations such as customer relationship management, financial planning or portfolio re-balancing. What has tripped up most firms is the most commoditized part of the cloud: Files and folders.

Cloud storage (replacing our internal servers) comes in three basic varieties.

• Basic, no-frills storage that simply mimics your offline server's file and folder structure. At a minimum, it should allow basic search, upload and download and possibly some level of access control

• The second type — secure file sharing — offers a secure method for distribution of files (even those that are mega-sized) but does not provide the general storage and organizational facility of an offline server. This will include encryption, expiring sharing of files and support for tracking of when those files were received.

• Finally, there is the server in the cloud model, offering fully featured cloud server storage, with everything you have in an offline server, as well as the secure distribution of files and folders, tagging and search, collaboration features and perhaps even disaster recovery services.

A KEY TERM TO REMEMBER

Encryption at rest. Encryption is the method through which a file is secured and only visible to someone with the proper key to unlock it. Encryption at rest is a more recent technique of insuring that all data stored in a cloud destination is encrypted at all times, thus reducing the possibility that someone unauthorized could be exposed to your data, even if unintentional (such as customer service personnel or engineers).

Before focusing on the vendor, let's cover the basics for stepping up security for yourself as a precursor to using the cloud.

1. Ensure your laptops and desktops are hard-disk encrypted so that data is secured at rest on your computers even when offline. Thus, if someone steals your physical computers, they have gotten their hands on a fantastic paperweight and not the confidential data you seek to protect. There is a subplot here. It is assumed you will then have a backup service for that secured data in the event you do lose that computer and need to restore it to a new machine.

2. Your portable devices must be secured by at minimum a pin or password to unlock and use. Optimally you'll also have a security app (now available from Lookout, Trend Micro and Symantec). These apps scan for malware, offer varying levels of data backup and offer location services in the event a device is lost. Also ensure you are securing your use of public WiFi connections using a service like VPN1Click or Cloak.

3. All of your online accounts that support it should have two-factor authentication enabled. This is no longer a decision to make. Regardless of inconvenience, the password security model is broken and we are responsible for data that is far too precious to put at risk.

4. Your cloud storage provider should be able to substantiate that it stores your data encrypted at rest, on its platform. The provider also should vouch for backup or

redundancy.

What are some standards to use to evaluate? Certainly requirements will have some unique twists based on your business and its service model, but there are some constants.

Here are some key questions to consider when evaluating cloud storage:

• How does the provider support Finra and/or SEC regulations governing your storage and use of business data?

• Does the cloud provider have a key to decipher the encryption provided to you for security of your data?

• What level of SSL encryption is used for the web browser connectivity, where file transfer also occurs? This is technical but important to understand.

• Can you ship an encrypted drive to transfer large amount of data? This allows you to implement a new solution and securely shift gigabytes or even terabytes of data onto your new cloud storage without risking the underlying information.

• How can you manage users, adding and removing them to protect data as changes occur in your business? Can you enforce two-factor authentication and other business rules on remote employees? Can you control how files and folders can be shared?

• What devices can you use with the service and does security extend to those apps and devices, including for syncing data?

• What integrations are available, such as connectivity to CRM, proposal or project management tools and other systems used in your business? How is your data secured when in transit with those integrations?

It's important to take seriously the evaluation of any solution, not just the cloud. Don't assume anything and ask for confirmation of your questions on backup, security and redundancy. Moreover, it is key to remember that nothing is (nor has ever been) bulletproof from bad actors who seek to compromise systems.

While the cloud is a convenient scapegoat as security risk, there is no alternative and there won't be one as our systems continue to interconnect and become web-distributed. By taking the steps to shore up your own security habits and carefully selecting your cloud providers, you can greatly minimize the risk of being a victim.

Blane Warrene speaks and writes frequently on technology and the intersection of *marketing and compliance in financial services. He co-founded Arkovi and QuonWarrene, the former acquired by RegEd in 2012. He produces the Digital Well podcast.*

PowerPoint Presentation:

Compliance Roundtable

By Randy Mullikin, Nicholas Madsen, Denise Saxon, and Jennifer Luginbill

Kansas

Office of the Securities Commissioner

Slide 1

OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Compliance Roundtable

Randy Mullikin KSC

Nicholas Madsen SEC

Denise Saxon SEC

Jennifer Luginbill FINRA

Kansas
Office of the Securities Commissioner

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Slide 2

Kansas IA & BD Registration

- Investment Advisers – 150 domiciled in Kansas.
- Broker Dealers- 27 domiciled in Kansas and 1,700 branch offices.
- Denver Regional SEC Territory – Federally Registered Investment Advisers
- SEC Registration Requirements for Investment Advisers.

Kansas
Office of the Securities Commissioner

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Slide 3

Is your investment adviser likely to register in the upcoming year with the SEC?

- Yes
- No

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3

Slide 4

Examination Authority

- Examinations are authorized by K.S.A. 17-12a411(d).
- Covers both broker dealers and investment advisers.
- Examinations may be conducted without prior notice.
- May copy and remove all records considered necessary to conduct the examination.

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Kansas Office of the Securities Commissioner

Slide 5

Kansas Open Records Act (KORA) K.S.A. 45-215

- Records obtained during an examination are not subject to dissemination under KORA.
- Records can be shared with other regulators or disclosed for purpose of a civil or administrative action.
- Correspondence between the KSC and registrant may be subject to KORA, including informal resolution of deficiencies.

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Kansas Office of the Securities Commissioner

Slide 6

What is the primary goal for an examination program?

- General compliance with regulations.
- Detect unethical practices.

6

Kansas Office of the Securities Commissioner

Slide 7

Business models of a state registered investment adviser

- AUM/Financial Planner
- Affiliate Broker Dealer
- Agent for a Branch Office of a Broker Dealer
- Investment Adviser Representative of an Investment Adviser registered with the U.S. SEC
- Insurance Agent
- Tax Preparation
- Accounting Firm
- Law Office

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Kansas Office of the Securities Commissioner

Slide 8

Do you provide a financial plan for which you collect a fee?

- Yes
- No

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Kansas Office of the Securities Commissioner

Slide 9

What to expect during an examination by KSC?

- Receive a phone call from an examiner announcing the exam.
- Phone interview to verify aspects of your business model.
- Receive a letter requesting the production of documents and information.
- Use sampling techniques to determine compliance.
- Conduct field work, generally no more than a day on a mutually agreed date.

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Kansas Office of the Securities Commissioner

Slide 10

Has your investment adviser been examined by another state?

- Yes
- No

Slide 11

Standard areas for review by the KSC

- What services are provided by the investment adviser?
- Are the adviser's personnel properly registered as an IAR?
- Does the adviser maintain the required books and records?
- Does the adviser meet the minimum financial requirement?
- Does the adviser maintain adequate client financial information to justify recommendations?
- Does the adviser conduct an annual compliance review of its business?

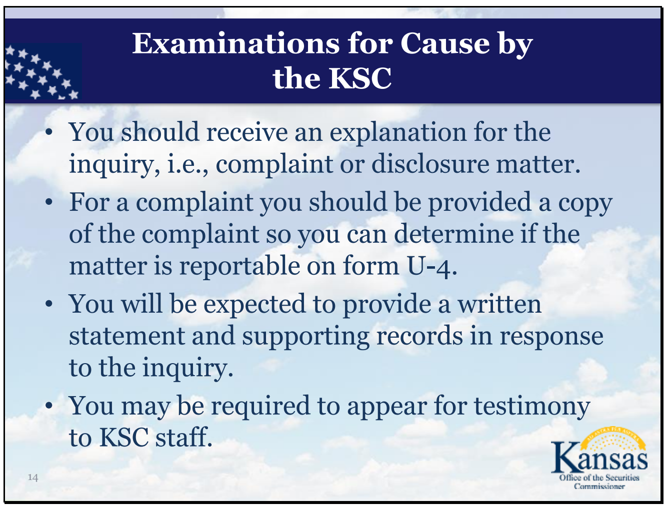
Slide 12

What are the current examination priorities for KSC?

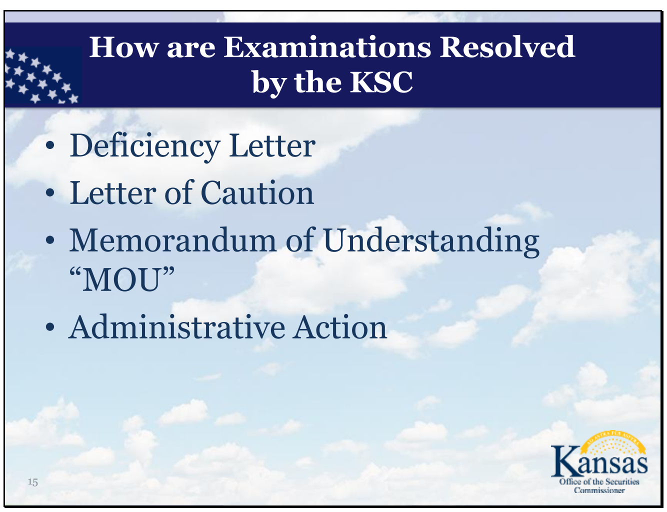
- Does the ADV Part 2 accurately describe business model?
- Are electronic records being properly maintained?
- What potential conflicts of interest exist?
- Do the adviser's representatives have recent CRD disclosures?
- Does the adviser have repeat violations from the prior exam?

Slide 13

Slide 14



Slide 15



Slide 16

Is a broker dealer required to supervise the actions of an IAR that is also a registered representative?

- Yes
- No

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Slide 17

Broker Dealer Examinations

- Investment Advisory transactions are generally executed through a broker dealer.
- FINRA and SEC exam practices for broker dealers whose business model includes an advisory component.
- State Registered Adviser is an Outside Business Activity – FINRA Rule 3270.

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Slide 18

Duty of Care for Broker Dealer versus Investment Adviser

- Suitability versus Fiduciary – what is the discernible difference in levels of service.
- FINRA Rule 2110 "Standards of Commercial Honor and Principals of Trade."

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Slide 19

Supervision by a Broker Dealer

- Broker Dealer – written agreement with an independent IAR.
- Periodic review of exception reports.
- Internal audits by the broker dealer.
- Private Securities Transactions, FINRA NTMs 94-44 & 96-33.

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Slide 20

If you are a registered representative of a broker dealer, does your broker dealer review the content of your ADV, Part 2?

- Yes
- No

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Slide 21

Crossover considerations for a Broker Dealer

- Which type of account – commissioned or asset based fees?
- Levels of trading – buy and hold strategy.
- Advisory fees on top of commissions.
- Consolidated client account statements by the investment adviser.
- Advertising/Correspondence.
- CRD disclosures and customer complaints – form U-4 filings.

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Office of the Securities Commissioner

Supplemental Materials:

Compliance Roundtable

By Randy Mullikin, Nicholas Madsen, Denise Saxon, and Jennifer Luginbill

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Joshua A. Ney, Commissioner

Sam Brownback, Governor

Kansas Statutes Governing Examinations

K.S.A. 17-12a411. Postregistration requirements. (d) ***Audits or inspections.*** The records of every person issuing or guaranteeing any securities subject to the provisions of this act and of every broker-dealer, agent, investment adviser or investment adviser representative registered or required to be registered under this act are subject to such reasonable periodic, special, or other audits or inspections by a representative of the administrator, within or without this state, as the administrator considers necessary or appropriate in the public interest and for the protection of investors. An audit or inspection may be made at any time and without prior notice. The administrator may copy, and remove for audit or inspection copies of, all records the administrator reasonably considers necessary or appropriate to conduct the audit or inspection. The administrator may assess a reasonable charge for conducting an audit or inspection under this subsection.

K.S.A. 45-215 Kansas Open Records Act. Records obtained during an examination are not subject to dissemination under the Kansas Open Records Act. However, as provided in K.S.A. 17-12a607(c) the records can be shared with other regulators or disclosed for the purpose of a civil or administrative action. In addition, all correspondence between the compliance staff and the registrant is likely to be subject to the Kansas Open Records Act once the examination is concluded, including any informal resolution of deficiencies that is not reportable on the CRD system. Confidential information such as social security numbers and client identifiers would be redacted from any such disclosure.

PUBLIC RECORDS MAINTAINED BY THE KSC INCLUDE:

- Registration records for broker-dealers and their agents (registered representatives or stockbrokers) maintained on the CRD system;
- Registration and notice filing records for investment adviser firms and representatives maintained on the IARD system;
- Securities registration and exemption filing records;
- Disciplinary histories, if any, of firms or individuals currently or previously registered or notice-filed in Kansas;
- Administrative action records;
- "No Action" and interpretive opinion letters; and
- Special Orders.

AGENCY RECORDS EXEMPT FROM PUBLIC DISCLOSURE INCLUDE:

- Records obtained in the course of an audit or investigation;
- Information which could reveal the identity of an undercover agent or informant;
- Agency records involving open administrative cases or civil litigation;
- Records protected by the attorney-client privilege or the rules of evidence;
- Certain correspondence between the agency and private individual(s);
- Public records that contain information of a personal nature; and
- Personnel records.

Regulation of Investment Advisers

by the

U.S. Securities and Exchange Commission

March 2013

Staff of the Investment Adviser Regulation Office
Division of Investment Management
U.S. Securities and Exchange Commission

Regulation of Investment Advisers by the U.S. Securities and Exchange Commission[*]

I. Introduction

Money managers, investment consultants, and financial planners are regulated in the United States as "investment advisers" under the U.S. Investment Advisers Act of 1940 ("Advisers Act" or "Act") or similar state statutes. This outline describes the regulation of investment advisers by the U.S. Securities and Exchange Commission ("SEC").

The Advisers Act is the last in a series of federal statutes intended to eliminate abuses in the securities industry that Congress believed contributed to the stock market crash of 1929 and the depression of the 1930s. The Act is based on a congressionally-mandated study of investment companies, including consideration of investment counsel and investment advisory services, carried out by the SEC during the 1930s.[1] The SEC's report traced the history and growth of investment advisers and reflected the position that investment advisers could not properly perform their function unless all conflicts of interest between them and their clients were removed. The report stressed that a significant problem in the industry was the existence, either consciously or, more likely, unconsciously, of a prejudice by advisers in favor of their own financial interests.

The SEC's report culminated in the introduction of a bill that, with some changes, became the Advisers Act. The Act, as adopted, reflects congressional recognition of the delicate fiduciary nature of the advisory relationship, as well as Congress' desire to eliminate, or at least expose, all conflicts of interest that might cause advisers, either consciously or unconsciously, to render advice that is not disinterested.[2]

The outline that follows is divided into five sections, each of which addresses a different question: Who is an "investment adviser?" Which investment advisers must register with the SEC? Who must register under the Act? How does an investment adviser register under the Act? What are the requirements applicable to an investment adviser registered under the Act?

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[*] The U.S. Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed in this outline are those of the staff of the Investment Adviser Regulation Office, and do not necessarily reflect the views of the U.S. Securities and Exchange Commission or others on the staff of the U.S. Securities and Exchange Commission. The Investment Adviser Regulation Office would like to thank Robert E. Plaze, the original author of this outline, for his substantial contribution.

[1] *See Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services*, H.R. Doc. No. 477, 76th Cong., 2d Sess. (1939).

[2] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 189, 191-192 (1963).

II. Who is an Investment Adviser?

A. Definition of Investment Adviser

Section 202(a)(11) of the Act defines an investment adviser as any person or firm that:

- for compensation;
- is engaged in the business of;
- providing advice to others or issuing reports or analyses regarding securities.

A person must satisfy all three elements to fall within the definition of "investment adviser," which the SEC staff has addressed in an extensive interpretive release explaining how the Act applies to financial planners, pension consultants and other persons who, as a part of some other financially related services, provide investment advice.[3] Published in 1987, Investment Advisers Act Release No. 1092 represents the views of the Division of Investment Management, which is primarily responsible for administering the Act.

1. *Compensation.* The term "compensation" has been broadly construed. Generally, the receipt of any economic benefit, whether in the form of an advisory fee, some other fee relating to the total services rendered, a commission, or some combination, satisfies this element.[4] The person receiving the advice or another person may pay the compensation.

2. *Engaged in the Business.* A person must be engaged in the business of providing advice. This does not have to be the sole or even the primary activity of the person. Factors used to evaluate whether a person is engaged are: (i) whether the person holds himself out as an investment adviser; (ii) whether the person receives compensation that represents a clearly definable charge for providing investment advice; and (iii) the frequency and specificity of the investment advice provided.[5] Generally, a person providing advice about specific securities will be "engaged in the business" unless specific advice is rendered only on a rare or isolated occasion.[6]

---

[3] *Applicability of the Investment Advisers Act of 1940 to Financial Planners, Pension Consultants, and Other Persons Who Provide Others with Investment Advice as a Component of Other Financial Services*, Investment Advisers Act Release No. 1092 (Oct. 8, 1987) ("Release 1092").

[4] *Id.*; *see also Kenisa Oil Company*, SEC Staff No-Action Letter (May 6, 1982); *SEC v. Fife*, 311 F. 3d 1 (1st Cir. 2002) (a person provides advice "for compensation" if it understands that successful investment will yield it a commission); *In the Matter of Alexander V. Stein*, Investment Advisers Act Release. No. 1497 (June 8, 1995) (a person receives "compensation" if it fraudulently converts client funds to its own use).

[5] *Zinn v. Parish,* 644 F.2d 360 (7th Cir. 1981); Release 1092, *supra* note 3.

[6] For instance, the SEC staff would not view an employer providing advice to an employee in connection with an employer-sponsored employee benefit program to be in the business of providing advice, *see Letter to Olena Berg, Assistant Secretary, Department of Labor, from Jack W. Murphy, Chief Counsel, Division of Investment Management, SEC* (Feb. 22, 1996). *See also Zinn, supra* note 5 at 364 ("isolated transactions with a client as an incident to the main purpose of his management contract to negotiate football contracts do not constitute engaging in the business of advising others on investment securities.").

3. *Advising Others about Securities*

a. *Advice about Securities.* A person clearly meets the third element of the statutory test if he provides advice to others about specific securities, such as stocks, bonds, mutual funds, limited partnerships, and commodity pools. The SEC staff has stated that advice about real estate, coins, precious metals, or commodities is not advice about securities.[7] The more difficult questions arise with less specific advice, or advice that is only indirectly about securities. The SEC staff has stated in this regard:

(i) advice about market trends is advice about securities;[8]

(ii) advice about the selection and retention of other advisers is advice about securities;[9]

(iii) advice about the advantages of investing in securities versus other types of investments (*e.g.*, coins or real estate) is advice about securities;[10]

(iv) providing a selective list of securities is advice about securities even if no advice is provided as to any one security;[11] and

(v) asset allocation advice is advice about securities.[12]

b. *Advising Others.* Questions about whether a person advises "others" usually arise when a client is not a natural person. The SEC staff generally looks to the substance of the arrangement rather than its form:

(i) A general partner of a limited partnership that provides advice with respect to the investments of partnership assets is advising others (the limited partners) even where the general partner may have legal title to these assets.[13]

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7 *Robert R. Champion*, SEC Staff No-Action Letter (Sept. 22, 1986).

8 *Dow Theory Forecasts*, SEC Staff No-Action Letter (Feb. 2, 1978). Thus, market-timing advice is advice about securities. *See Maratta Advisory, Inc.*, SEC Staff No-Action Letter (July 16, 1981).

9 Release 1092, *supra* note 3; *FPC Securities Corp.*, SEC Staff No-Action Letter (Dec. 1, 1974). *See also SEC v. Bolla,* 401 F.Supp. 43 (D.D.C. 2005), *aff'd. in relevant part, SEC v. Washington Investment Network,* 475 F.3d 392 (D.C. Cir. 2007) (person selecting investment advisers for clients meets the Advisers Act's definition of "investment adviser").

10 Release 1092, *supra* note 3.

11 *RDM Infodustries, Inc.,* SEC Staff No-Action Letter (Mar. 25, 1996). The SEC staff takes the position that providing information about securities in a report does not constitute providing advice about the securities if: (i) the information is readily available to the public in its raw state; (ii) the categories of information presented are not highly selective; and (iii) the information is not organized or presented in a manner that suggests the purchase, holding, or sale of any security. *See id.*

12 *Maratta Advisory, Inc., supra,* note 8. *See also SEC v. Bolla, supra,* note 9.

13 *Abrahamson v. Fleschner,* 566 F.2d 862, 870 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978); *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007).

(ii) A wholly-owned corporate subsidiary exclusively advising the parent or another wholly owned corporate subsidiary would not generally be considered advising "others."[14]

c. *Investment Banking.* The SEC staff does not believe that the Act applies to persons whose activities are limited to advising issuers concerning the structuring of their securities offerings (although such advice may technically be about securities).[15]

d. *Non-U.S. Clients.* The Act is silent regarding whether the clients must be U.S. persons. The SEC takes the position that a U.S. person providing advice exclusively to non-U.S. persons would still be subject to the Act.[16]

B. Exclusions from Definition

There are several exclusions from the investment adviser definition available to persons who presumably (or at least arguably) satisfy all three elements of the definition. A person eligible for one of the exclusions is not subject to any provisions of the Act.

1. *Banks and Bank Holding Companies.* This exclusion is generally limited to U.S. banks and bank holding companies.[17] The SEC staff has stated that the exclusion is unavailable to non-U.S. banks,[18] credit unions, and investment adviser subsidiaries of banks or bank holding companies.[19]

2. *Lawyers, Accountants, Engineers, and Teachers.* The professional exclusion is available only to those professionals listed, and only if the advice given is incidental to the practice of their profession. Factors considered by staff to evaluate whether advice is incidental to a profession are: (i) whether the professional holds himself out as an investment adviser; (ii) whether the advice is reasonably related to the professional services provided; and (iii) whether the charge for advisory services is based on the same factors that

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14 *See Zenkyoren Asset Management of America Inc.*, SEC Staff No-Action Letter (June 30, 2011).

15 *See, e.g., The Applicability of the Investment Advisers Act of 1940 to Financial Advisors to Municipal Bond Issuers, Division of Investment Management*, SEC Staff Legal Bulletin No. 11 (Sept. 19, 2000), *available at* http://www.sec.gov/interps/legal.shtml.

16 *See* Release 3221, *infra* note 46, at n.76.

17 The term "bank" is defined in section 202(a)(2) of the Act. In 2001, the Act's definition of "investment adviser" was amended so that banks and bank holding companies are not eligible for this exclusion to the extent that they serve or act as an investment adviser to a registered investment company. However, if, in the case of a bank, such services or actions are performed through a separately identifiable department or division, the department or division, and not the bank itself, is deemed to be the investment adviser. The term "separately identifiable department or division" is defined in section 202(a)(26).

18 *Letter to Rep. William J. Hughes from Stanley B. Judd, Deputy Chief Counsel, Division of Investment Management,* SEC (June 4, 1980).

19 *First Commerce Investors, Inc.*, SEC Staff No-Action Letter (Jan. 31, 1991); *Southwest Corporate Federal Credit Union*, SEC Staff No-Action Letter (May 31, 1983).

determine the professional's usual charge.[20]

3. *Brokers and Dealers.* A broker or dealer that is registered with the SEC under the Securities and Exchange Act of 1934 ("Exchange Act") is excluded from the Act if the advice given is: (i) solely incidental to the conduct of its business as broker or dealer, and (ii) it does not receive any "special compensation" for providing investment advice.

    a. *Solely Incidental.* The SEC has stated that investment advice is "solely incidental" to brokerage services when the advisory services rendered are "in connection with and reasonably related to the brokerage services provided."[21] If advice is not "solely incidental," a broker-dealer is subject to the Advisers Act regardless of the form of compensation it receives.

    b. *Special Compensation.* Generally, to avoid receiving "special compensation," a broker or dealer relying on this exclusion must receive only commissions, markups, and markdowns.[22]

       Bundled Fees. The SEC has stated a broker or dealer that receives a fee based on a percentage of assets that compensates the broker or dealer for both advisory and brokerage services receives "special compensation."[23]

       Separate or Identifiable Charge. The SEC has stated that a broker-dealer charges "special compensation" when it charges its customer a separate fee for investment advice, or when it charges its customers different commission rates, one with advice and one without, because the difference represents a clearly definable charge for investment advice.[24]

       Broker-Dealer Agents. The SEC staff has stated that a registered representative of a broker-dealer can rely on the exclusion if she is: (i) giving advice within the scope of her employment with the broker-

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[20] Release 1092, *supra* note 3; *Henry S. Miller Companies of Dallas, Texas*, SEC Staff No-Action Letter (Feb. 21, 1975).

[21] *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Investment Advisers Act Release No. 2376 (Apr. 12, 2005) ("Release 2376"), *available at* http://www.sec.gov/rules/final/34-51523.pdf.

[22] Section 202(a)(11)(C). *See* S. Rep. No. 76-1775 at 22; H.R. Rep. No. 76-2639 at 28 (the term "investment adviser" was "so defined as specifically to exclude . . . brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive only brokerage commissions.")).

[23] In Release 2376, the SEC adopted a rule that, among other things, deemed brokers charging asset-based brokerage fees (rather than commissions, mark-ups, or mark-downs) not to be investment advisers based solely on their receipt of special compensation. The rule was vacated for other reasons by a federal court in March 2007. *Financial Planning Association v. SEC*, 482 F.3d (D.C. Cir. 2007). *See also National Regulatory Services*, SEC Staff No-Action Letter (Dec 2, 1992) at n.3.

[24] *Final Extension of Temporary Exemption from the Investment Advisers Act for Certain Brokers and Dealers*, Investment Advisers Act Release No. 626 (Apr. 27, 1978) ("Release 626"). *See also, Opinion of the General Counsel Relating to Section 203(b)(3) of the Investment Advisers Act of 1940*, Investment Advisers Act No. 2 (Oct. 28, 1940). The Commission proposed to codify this interpretation in a rule. *See Interpretive Rule under the Advisers Act Affecting Broker-Dealers*, Investment Advisers Act Release No. 2652 (Sept. 24, 2007).

dealer; (ii) the advice is incidental to her employer's brokerage activities; and (iii) she receives no special compensation for her advice.[25]

Brokerage Customers. The SEC has stated that a broker-dealer does not have to treat its brokerage customers to whom it provides investment advice as advisory clients simply because it is registered under the Advisers Act. It must treat as an advisory client only those accounts for which it provides advice (*i.e.*, non-incidental advice) or receives compensation (*i.e.*, special compensation) that subjects the broker-dealer to the Advisers Act.[26]

4. *Publishers.* Publishers are excluded from the Act, but only if a publication: (i) provides only impersonal advice (*i.e.,* advice not tailored to the individual needs of a specific client);[27] (ii) is "bona fide," (containing disinterested commentary and analysis rather than promotional material disseminated by someone touting particular securities); and (iii) is of general and regular circulation (rather than issued from time to time in response to episodic market activity).[28]

5. *Government Securities Advisers.* This exclusion is available to persons and firms whose advice is limited to certain securities issued by or guaranteed by the U.S. government.[29]

6. *Credit Rating Agencies.* This exclusion is available to any rating agency regulated under section 15E of the Exchange Act as a "nationally recognized statistical rating organization."[30]

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25 *Institute of Certified Financial Planners*, SEC Staff No-Action Letter (Jan. 21, 1986).

26 Release 626, *supra* note 24. The Commission has proposed to codify this interpretation in a rule. *See Interpretive Rule under the Advisers Act Affecting Broker-Dealers*, *supra* note 24.

27 *See Weiss Research, Inc., et al*, Investment Advisers Act Release No. 2525 (June 22, 2006) (newsletter publisher deemed to be an investment adviser providing personalized investment advice whose "auto-trading" program sent signals to broker-dealer, which automatically traded subscriber/customer securities consistent with signals).

28 Section 202(a)(11)(D). *See Lowe v. SEC*, 472 U.S. 181 (1985); *SEC v. Gun Soo Oh Park, A/K/A Tokyo Joe, and Tokyo Joe's Societe Anonyme Corp.*, 99 F. Supp. 2d 889 (N.D. Ill. 2000). If a publisher is required to register as a result of some other advisory activity, the adviser is subject to all of the provisions of the Act and SEC rules with respect to the publication. *See* Investment Advisers Act Release No. 870 (July 15, 1983)("Release 870").

29 Section 202(a)(11)(E). The scope of the exception includes persons whose advice is limited to: (i) direct obligations of the Federal government (*e.g.*, U.S. Treasury obligations); (ii) securities subject to guarantees from the Federal government; and (iii) securities issued by or guaranteed by corporations whose securities are designated by the Secretary of the Treasury as exempt from the Exchange Act. The SEC staff has stated that advice about repurchase agreements collateralized by U.S. government securities does not fall within the exception. *J.Y. Barry Arbitrage Management, Inc.*, SEC Staff No-Action Letter (Oct. 18, 1989). *See also In the Matter of Rauscher Pierce Refsnes, Inc., et al.*, Investment Advisers Act Release No. 1863 (Apr. 6, 2000) ("Because Rauscher's advice was not limited to Treasury securities or other government securities as described in section 202(a)(11)(E), that provision did not operate to exclude Rauscher from the definition of investment adviser.").

30 Section 202(a)(11)(F), containing this exclusion for rating agencies, was added to the Act by the Credit Rating Agency Reform Act of 2006. Pub. L. No. 109-291, 120 Stat. 1327 (Sept. 29, 2006).

7. *Family Offices.* A family office that manages the wealth and other affairs of a single family is excluded from the investment adviser definition if it: (i) provides investment advice only to family clients; (ii) is wholly owned by family clients and exclusively controlled by family members and/or certain family entities; and (iii) does not hold itself out[31] to the public as an investment adviser.[32]

   a. *Family Members.* A family office's "family members" include all lineal descendants (including adopted children, stepchildren, foster children, and, in some cases, persons who were minors when a family member became their legal guardian) of a common ancestor (no more than 10 generations removed from the youngest generation of family members), and such lineal descendants' spouses or spousal equivalents.[33]

   b. *Family Clients.* The family office's clients generally may include family members; key employees; any non-profit or charitable organization funded exclusively by family clients; any estate of a family member, former family member, key employee, or subject to certain conditions, a former key employee; certain family client trusts; and any company wholly owned by and operated for the sole benefit of family clients.[34]

8. *Governments and Political Subdivisions.* The Act does not apply to the U.S. government, state governments and their political subdivisions, and their agencies or instrumentalities, including their officers, agents, or employees acting in their official capacities.[35]

9. *Non-U.S. Advisers.* There is no exemption for non-U.S. advisers. Non-U.S. persons advising U.S. persons are subject to the Act and must register under the Act[36] unless eligible for one of the exemptions discussed below (*e.g.*, the "foreign private adviser" registration exemption).[37] The SEC does not accept "home state registration" of non-U.S. advisers in lieu of SEC

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31 *See infra* notes 69 to 72 and accompanying text for discussion of "holding out."

32 Rule 202(a)(11)(G)-1(b)(defining "family office" for purpose of section 202(a)(11)(G), which was added to the Act by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act")). Family offices that do not meet these conditions must register with the SEC unless another exemption is available. Rule 202(a)(11)(G)-1(e)(2).

33 Rule 202(a)(11)(G)-1(d)(6).

34 Rule 202(a)(11)(G)-1(d)(4). Key employees include executive officers, directors, trustees, general partners, or any person serving in a similar capacity for the family office or its affiliated family office, and certain employees who have participated in the investment activities of the family office or its affiliated family office for at least 12 months. Rule 202(a)(11)(G)-1(d)(8).

35 Section 202(b).

36 *In the Matter of Banco Espirito Santo S.A.*, Investment Advisers Act Release No. 3304 (Oct. 24, 2011) (The SEC brought an enforcement action against a commercial bank headquartered in Portugal for violating section 203(a) by marketing its portfolio of financial services, including offering securities and providing advice regarding those securities, to U.S. residents who were primarily Portuguese immigrants without registering with the Commission.).

37 *See* Section III. B. 3 of this outline for discussion of the foreign private adviser exemption.

registration.[38]

The SEC has authority to designate, by rule or order, other persons who are not within the intent of the definition of investment adviser.[39]

III. Which Investment Advisers Must Register Under the Advisers Act?

A firm that falls within the definition of "investment adviser" (and is not eligible for one of the exclusions) must register under the Advisers Act, unless it (i) is prohibited from registering under the Act because it is a smaller firm regulated by one or more of the states or (ii) qualifies for an exception from the Act's registration requirement.[40] All advisers, registered or not, are subject to the Act's anti-fraud provisions.

A. Prohibitions from Registration

Until 1996, most investment advisers were subject to regulation by both the SEC *and* one or more state regulatory agencies. The Act was amended in 1996 and again in 2010 to allocate regulatory responsibility between the SEC and the states.[41] Today, most small advisers and "mid-sized advisers" are subject to state regulation of advisers and are *prohibited* from registering with the SEC.[42] Most large advisers (unless an exemption is available) must register with the SEC, and state adviser laws are preempted for these advisers.[43]

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38 On June 12, 2007, the SEC held a "roundtable discussion" at which the possibility of revising its approach to mutual recognition was discussed. The SEC press release concerning the roundtable stated that "selective mutual recognition would involve the SEC permitting certain types of foreign financial intermediaries to provide services to U.S. investors under an abbreviated registration system, provided those entities are supervised in a foreign jurisdiction under a securities regulatory regime substantially comparable (but not necessarily identical) to that in the United States." *See* http://www.sec.gov/spotlight/mutualrecognition.htm.

39 Section 202(a)(11)(H). *See, e.g., International Bank for Reconstruction and Development and International Development*, Investment Advisers Act Release Nos. 1971 (Sept. 4, 2001) (notice) and 1955 (July 27, 2001) (order) (declaring World Bank instrumentalities not to be investment advisers under the Act). Section 202(a)(11)(H) had been designated as section 202(a)(11)(F) until 2006, and as 202(a)(11)(G) until 2011, when it was re-designated by the Dodd-Frank Act.

40 Section 203(a).

41 *National Securities Markets Improvements Act of 1996* ("NSMIA"), Pub. L. No. 104-290, 110 Stat. 3416 (1996); Dodd-Frank Act, *supra* note 32. Most of the provisions amending the Advisers Act to allocate regulatory responsibilities between the SEC and state governments have been codified in section 203A.

42 Section 203A(a). Section 203A creates a *prohibition*, not an exemption. *See In the Matter of Matthew P. Brady*, Investment Advisers Act Release No. 2178 (Sept. 30, 2003); *In the Matter of Warwick Capital Management Inc.*, Initial Decision Release No. 327 (Feb. 15, 2007); *Credit Agricole Asset Management Alternative Investments, Inc.*, SEC Staff No-Action Letter (Aug. 7, 2006). *See also In the Matter of Royal Oak Capital Management, LLC*, Investment advisers Act Release No. 3354 (Jan. 17, 2012) (cancelling the registration of an adviser that did not have required amount of assets under management to remain registered with the SEC).

43 *See* Sections 203(a) (registration required) and 203A(b) (preemption of state law).

1. *Operation of Section 203A of the Advisers Act*

   a. *Small Advisers.* Advisers with less than $25 million of assets under management are regulated by one or more states *unless* the state in which the adviser has its principal office and place of business has not enacted a statute regulating advisers.[44] Thus, unless an exemption is available (discussed below), only a small adviser with its principal office and place of business in Wyoming (which has not enacted a statute regulating advisers) may register with the SEC.

   b. *Mid-Sized Advisers.* Generally advisers with between $25 million and $100 million of assets under management[45] are regulated by one or more states if (i) the adviser *is registered* with the state where it has its principal office and place of business (*e.g.*, it cannot take advantage of an exemption from state registration), and (ii) the adviser is "subject to examination" by that state securities authority.[46] Unless an exemption is available, a mid-sized adviser with its principal office and place of business in New York or Wyoming is not "subject to examination" and must register with the SEC.[47]

   c. *Non-U.S. Advisers.* Advisers whose principal office and place of business is outside the United States are not prohibited from registering with the SEC and thus are not subject to the assets under management thresholds.[48] A non-U.S. adviser giving advice to U.S. persons[49] must register with the SEC (and thus may avoid registration with state regulators), unless an exemption from registration is

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44 Section 203A(a)(1) prohibits any adviser from registering with the SEC that is *regulated or is required to be regulated* in the state in which it maintains its principal office and place of business. The SEC interprets this provision to mean the prohibition applies only to an adviser that maintains its principal office and place of business in a state that has enacted an investment adviser statute. *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1633 (May 15, 1997) ("Release 1633") at n.83 and accompanying text.

45 The Dodd-Frank Act raised the threshold for advisers to register with the SEC to $100 million of assets under management. *See* section 410 of Dodd-Frank Act. A mid-sized adviser *may* register when it acquires $100 million of assets under management and *must* register once it obtains $110 million of assets under management, unless some other exemption is available. Rule 203A-1(a)(1). Once registered with the SEC, a mid-sized adviser is not required to withdraw from SEC registration and register with the states until the adviser has less than $90 million of assets under management. *Id.*

46 Section 203A(a)(2) prohibits a mid-sized adviser from registering with the SEC if the adviser is required to be registered as an adviser in the state where it has its principal office and place of business and is subject to examination by that state. *See Rule Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3221 (June 22, 2011) ("Release 3221").

47 *See* Instructions for Item 2 of Part 1A of Form ADV; Division of Investment Management: Frequently Asked Questions Regarding Mid-Sized Advisers, *available at* www.sec.gov/divisions/investment/midsizedadviserinfo.htm. New York and Wyoming did not advise the SEC staff that advisers registered with them are subject to examination. *See* Release 3221 at n.152, *supra* note 46.

48 *See* Release 1633, *supra* note 44 at Section II. E. An adviser with a principal office and place of business in another country does not have a principal office and place of business in a U.S. state that regulates investment advisers.

49 *See infra* note 64 for discussions of the definition of a "U.S. person."

available (in which case it may be subject to state registration requirements).[50]

2. *Exceptions to Prohibition.* Section 203A and SEC rules carve out several exceptions from the assets under management tests.

   a. *Advisers to Investment Companies.* Advisers to investment companies registered under the Investment Company Act of 1940 (the "Investment Company Act") must register with the SEC.[51] The exception is not available to an adviser that simply gives advice about investing in investment companies.[52]

   b. *Advisers to Business Development Companies.* Advisers with at least $25 million of assets under management that advise a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act must register with the SEC.[53]

   c. *Pension Consultants.* Advisers providing advisory services to employee benefit plans having at least $200M of assets may register with the SEC (even though the consultant does not itself have those assets under management).[54]

   d. *Related Advisers.* Advisers that control, are controlled by, or are under common control of an SEC-registered adviser may register with the SEC, but only if they have the same principal office and place of business.[55]

   e. *Newly-Formed Advisers.* Advisers that are not registered, and have a reasonable expectation that they will be eligible for SEC registration within 120 days of registering, may register with the SEC.[56]

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50 *See* Section III. A. 3 of this outline for discussion of exemption from registration for foreign private advisers.

51 Sections 203A(a)(1)(B); 203A(a)(2)(A).

52 *See* Instructions for Item 2 of Part 1A of Form ADV.

53 Section 203A(a)(2)(A). *See also* Item 2.A.(6) of Part 1A of Form ADV.

54 Rule 203(A)-2(a). In June 2011, the SEC increased the plan assets threshold required for pension consultants from $50 million to $200 million. *See* Release 3221, *supra* note 46. In May 2005, the SEC staff published a report detailing concerns with conflicts of pension fund consultants who help pension managers evaluate money managers. *See Staff Report Concerning Staff Examinations of Certain Select Pension Fund Consultants, available at* www.sec.gov/news/studies/pensionexamstudy.pdf. The SEC settled an administrative proceeding with a pension consultant that breached its fiduciary obligations by failing to disclose conflicts of interest. *In the Matter of Yanni Partners, Inc.*, Investment Advisers Act Release No. 2643 (Sept. 4, 2007) (pension consultant held itself out to be "independent" of money managers sold subscriptions to data base to money managers it was evaluating).

55 Rule 203A-2(b).

56 Rule 203A-2(c). An adviser relying on this exception must file an amendment to its Form ADV at the end of the 120 days indicating whether it has become eligible for SEC registration, or must withdraw its SEC registration. An adviser that expects to be eligible for SEC registration because of the amount of its assets under management must have $100M or more of assets under management no later than 120 days after its registration is declared effective. *See* Instructions for Item 2 of Part 1A of Form ADV.

f. *Multi-State Advisers.* Advisers that would otherwise be obligated to register with 15 or more states may register with the SEC.[57]

g. *Internet Advisers.* Certain advisers who provide advice though an interactive web site may register with the SEC.[58]

3. *State Law Still Applicable to SEC-Registered Advisers.* Although state investment adviser statutes do not apply to SEC-registered advisers, other state laws, including other state securities laws, do apply. In addition, state laws may (and most state laws continue to) require an SEC-registered adviser to:

   a. comply with state anti-fraud prohibitions;

   b. provide the state regulator with a copy of its SEC registration;

   c. pay state licensing and renewal fees; and

   d. license persons giving advice on behalf of the adviser, but only if the person has a place of business in the state.[59]

4. *Federal Anti-Fraud Law Still Applicable to State-Registered Advisers.* The SEC continues to institute enforcement actions against state-registered advisers charging violations of section 206 of the Act.[60]

B. <u>Exemptions from Registration</u>

The Advisers Act provides several exemptions from registration. The exemptions are voluntary; advisers eligible for them can nonetheless register with the SEC.[61]

1. *Intrastate Advisers.* Available to an adviser (i) all of whose clients are residents of the state in which the adviser maintains its principal office and place of business and (ii) that does not give advice about securities on any

57 Section 203A(a)(2)(A); Rule 203A-2(d).

58 Rule 203A-2(e). *Exemption for Certain Investment Advisers Operating Through the Internet*, Investment Advisers Act Release No. 2091 (Dec. 12, 2002), *available at* http://www.sec.gov/rules/final/finalarchive/finalarchive2002.shtml.

59 SEC-registered advisers can comply with state requirements that they provide states with a copy of their registration (so-called "notice filings"), pay state registration fees, and license advisory personnel (in most states) through the electronic filing system (IARD) discussed below.

60 *See, e.g., In the Matter of James William Fuller*, Investment Advisers Act Release No. 1842 (Oct. 4, 1999); *In the Matter of Robert Radano*, Investment Advisers Act Release No. 2750 (June 30, 2008); *SEC v. Aaron Donald Vallett and A.D. Vallett & Co., LLC*, Litigation Release No. 21557 (June 16, 2010). Most of the anti-fraud rules adopted by the SEC pursuant to its authority under section 206(4) of the Act (and discussed below) are not applicable to state-registered advisers. States have, however, adopted similar rules in many cases.

61 Persons who voluntarily register under the Advisers Act, in circumstances where their registration may not be required, are subject to all of the provisions and rules under the Advisers Act applicable to persons required to register. *See* Release 870, *supra* note 28. State regulatory law is not preempted for an adviser taking advantage of one of the exceptions from registration and thus the adviser may be required to register with one or more state securities regulators. *See* discussion of state preemption in Section III. A. of this outline.

national exchange.[62]

Updated →2. *Advisers to Insurance Companies.* Available to an adviser whose only clients are insurance companies.[63]

3. *Foreign Private Advisers.* Available to an adviser that (i) has no place of business in the United States; (ii) has, in total, fewer than 15 clients in the United States *and investors* in the United States in private funds advised by the adviser; (iii) has aggregate assets under management attributable to these clients and investors of less than $25 million; and (iv) does not hold itself out generally to the public in the United States as an investment adviser.[64]

The exemption for foreign private advisers was added by the Dodd-Frank Act and replaces the private adviser exemption (i.e., an exemption for any adviser with fewer than 15 clients) previously provided by the same section of the Act, which was repealed. The SEC incorporated many of the rules from "old" section 203(b)(3).

a. *Counting Clients*

(i) *Multiple Persons as a Single Client.* Rule 202(a)(30)-1 provides that the following can be considered a single client:[65]

(A) a natural person and (i) any minor child of the natural person; (ii) any relative, spouse, spousal equivalent, or relative of the spouse or of the spousal equivalent of the natural person with the same principal residence; and (iii) all accounts or trusts of which the persons described above are the only primary beneficiaries; or

(B) a corporation, general or limited partnership, limited liability company, trusts or other legal organization that receives investment advice based on its investment objectives (rather than the individual investment objectives of its owners),[66]

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62 Section 203(b)(1). The SEC staff takes the position that advice regarding investment companies involves advice about "listed securities" if the investment company invests in listed securities. *Roy Heybrock*, SEC Staff No-Action Letter (Apr. 5, 1992).

63 Section 203(b)(2). *See also TACT Asset Mgmt., Inc.*, SEC Staff No-Action Letter (Oct. 24, 2012) (stating that the staff would not recommend enforcement proceedings if a U.S. investment adviser whose only client is a foreign insurance company does not register with the SEC).

64 Section 203(b)(3) (exempting "any investment adviser that is a foreign private adviser"); Section 202(a)(30) (defining a "foreign private adviser"). Rule 202(a)(30)-1 defines the term "in the United States" by reference to the definitions of a "U.S. person" and the "United States" in Regulation S under the Securities Act, except that the rule treats as "in the United States" any discretionary account owned by a U.S. person and managed by a non-U.S. affiliate of the adviser. An adviser must assess whether a person is "in the United States" at the time the person becomes a client or, in the case of an investor in a private fund, each time the investor acquires securities issued by the fund. *See* rule 202(a)(30)-1, at note to paragraph (c)(3)(i).

65 Rule 202(a)(30)-1. The rule provides a non-exclusive safe harbor for counting clients for purposes of section 203(b)(3). *See* rule 202(a)(30)-1, at note to paragraphs (a) and (b).

66 An adviser must count an owner (*e.g.*, a limited partner) as a client if it provides advice to that owner "separate and apart" from the advice provided to the entity. Rule 202(a)(30)-1(b)(1). *Cf. Latham &*

and two or more of these entities that have identical owners.

(ii) *"Look through" private funds.* An adviser must count both its direct clients and each investor in any "private fund" it advises.

No Double Counting. An adviser may treat as a single investor any person who is an investor in two or more of the adviser's private funds.[67]

Nominal Holders. An adviser may be required to also "look through" persons who are nominal holders of a security issued by a private fund to count the investors in the nominal holder when determining if the adviser qualifies for the exemption. For example, holders of the securities of any feeder fund in a master-feeder arrangement may be deemed to be the investors of the master fund.[68]

b. *Holding Out.* The SEC staff views a person as holding himself out as an adviser if he advertises as an investment adviser or financial planner, uses letterhead indicating activity as an investment adviser, or maintains a telephone listing or otherwise lets it be known that he will accept new advisory clients,[69] or hires a person to solicit clients on his behalf.[70]

(i) *Participation in Non-Public Offerings.* Foreign private advisers will not be deemed to be holding themselves out generally to the public in the United States as an investment adviser solely because they participate in a non-public offering in the United States of securities issued by a private fund pursuant to an exemption from registration under the Securities Act of 1933.[71]

(ii) *Use of the Internet.* An adviser using the Internet to provide information about itself ordinarily would be "holding itself out" as an adviser. However, the SEC has stated that it will not consider a non-U.S. adviser, including foreign private advisers, to be holding itself out as an adviser if:

(A) *Prominent Disclaimer.* The adviser's web site includes a

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Watkins, SEC Staff No-Action Letter (Aug. 24, 1998); *Burr, Egan, Deleage & Co., Inc.*, SEC Staff No-Action Letter (Apr. 27, 1987).

67 Rule 202(a)(30)-1, at note to paragraph (c)(2).

68 *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No.3222 (June 22, 2011)("Release 3222") at Section II.C.2.

69 *See, e.g.*, *William Bloor*, SEC Staff No-Action Letter (Feb. 15, 1980); *Richard J. Shaker*, SEC Staff No-Action Letter (Aug. 1, 1977); *Al O'Brien Associates*, SEC Staff No-Action Letter (Oct. 6, 1973).

70 Investment Advisers Act Release No. 688 (July 15, 1979) at n.9. *See also Lamp Technologies, Inc.*, SEC Staff No-Action Letter (May 29, 1997) (investment adviser not "holding itself out generally to the public as an investment adviser" solely by virtue of posting information about certain private funds (*e.g.*, hedge funds) on a password-protected web site that is accessible only by accredited investors).

71 Rule 202(a)(30)-1(d).

prominent disclaimer making it clear that its web site materials are not directed to U.S. persons; and

(B) *Procedures.* The adviser implements procedures reasonably designed to guard against directing information about its advisory services to U.S. persons (*e.g.*, obtaining residency information before sending further information).[72]

4. *Charitable Organizations and Plans.* Available to an adviser that is a charitable organization or a charitable organization's employee benefit plan, including a trustee, officer, employee, or volunteer of the organization or plan to the extent that the person is acting within the scope of his employment or duties.[73]

5. *Commodity Trading Advisors*

   a. *Generally.* Available to any adviser that is registered with the U.S. Commodity Futures Trading Commission ("CFTC") as a commodity trading advisor and whose business does not consist primarily of acting as an investment adviser and that does not advise a registered investment company or a business development company.[74]

   b. *Commodity Trading Advisors to Private Funds.* Available to any adviser registered with the CFTC as a commodity trading advisor that advises a private fund, provided that the adviser must register with the SEC if its business becomes predominantly the provision of securities-related advice.[75]

6. *Private Fund Advisers.* Available to an adviser solely to private funds that has less than $150 million in assets under management in the United States.[76] An adviser that has any other type of client is not eligible for the exemption.[77]

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72 *Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore*, Investment Advisers Act Release No. 1710 (Mar. 23, 1998) section VI, *available at* http://www.sec.gov/rules/interp/interparchive/interparch1998.shtml.

73 Sections 203(b)(4) and (5) were added by the *Philanthropy Protection Act of 1995*, Pub. L. No. 104-62, 109 Stat. 682 (1995). *See also Sisters of Mercy*, SEC Staff No-Action Letter (Oct. 1, 2009).

74 Section 203(b)(6) (re-designated as 203(b)(6)(A) by Dodd-Frank Act) was added by the *Commodity Futures Modernization Act of 2000*, Pub. L. No. 106-554, 114 Stat. 2763 (2000), which also amended the Act's definition of "security" in section 202(a)(18) of the Act to include certain "securities futures." The Act repealed the ban on single stock or narrow-based stock index futures and established a framework for shared jurisdiction over the trading of these instruments and market participants. *See* Exchange Act Release No. 44288 (May 9, 2001), *available at* http://www.sec.gov/rules/proposed/34-44288.htm.

75 Section 203(b)(6)(B) of the Advisers Act (added by the Dodd-Frank Act).

76 Section 203(m) of the Advisers Act (added by the Dodd-Frank Act). The SEC adopted rule 203(m)-1 on June 22, 2011 to implement the section. *See* Release 3222, *supra* note 68.

77 Two nominally separate but related advisers may be considered to be one adviser (and their assets aggregated) if they do not operate sufficiently independent of one another.

a. *Private Funds.* A "private fund" is an issuer of securities that would be an investment company "but for" the exceptions provided for in section 3(c)(1) or 3(c)(7) of the Investment Company Act.[78]

(i) Section 3(c)(1) is available to a fund that does not publicly offer its securities and has 100 or fewer beneficial owners of its outstanding securities.

(ii) Section 3(c)(7) is available to a fund that does not publicly offer its securities and limits its owners to qualified purchasers.[79]

b. *Calculating Private Fund Assets*

(i) *Method of Calculation.* Generally, advisers must include the value of all private funds managed, including the value of any uncalled capital commitments.[80] Value is based on market value of those assets, or the fair value of those assets where market value is unavailable, and must calculate the assets on a gross basis, *i.e.,* without deducting liabilities, such as accrued fees and expenses or the amount of any borrowing.[81]

(ii) *Annual Assessment.* An adviser must assess annually whether it has $150 million or more of private fund assets under management. An adviser that meets or exceeds the $150 threshold must register with the Commission.[82]

c. *Non-U.S. Advisers.* An adviser with a principal office and place of business outside the United States may exclude consideration of non-U.S. clients, *i.e.*, it may rely on the exemption if (a) *all* of its clients that are United States persons[83] are qualifying private funds; and (b) any management at a U.S. place of business by the adviser is solely

78 Section 202(a)(29) of the Advisers Act.

79 The term "qualified purchasers" is defined in section 2(a)(51) of the Investment Company Act.

80 Form ADV: Instructions for Part 1A, instr. 5.b.(4). Proprietary assets, *i.e*, those of the adviser or its principals may not be excluded. Form ADV: Instructions for Part1A, instr. 5.b.(1).

81 *Id.* The SEC has recognized that, although many advisers will calculate the fair value of their private fund assets in accordance with Generally Accepted Accounting Principles ("GAAP") or another international accounting standard, other advisers acting consistently and in good faith may utilize another fair valuation standard. Release 3222, *supra* note 68 at nn.364-365 and accompanying text. Consistent with this good faith requirement, the SEC expects that an adviser that calculates fair value in accordance with GAAP or another basis of accounting for financial reporting purposes will also use that same basis for purposes of determining the fair value of its regulatory assets under management. *Id.* at n.365.

82 Rule 203(m)-1(c). A private fund adviser that had complied with all SEC reporting requirements applicable to an exempt reporting adviser, but reported in its annual updating amendment that fund assets exceeded $150 million, has up to 90 days after filing the annual updating amendment to apply for SEC registration, and may continue doing business as a private fund adviser during this time. General Instruction 15 to Form ADV.

83 Similar to the foreign private adviser exemption, a "United States person" generally is a "U.S. person," as defined in Regulation S under the Securities Act, except that a discretionary or other fiduciary account also is a "United States person" if the account is held for the benefit of a United States person by a non-U.S. fiduciary who is a related person of the adviser. Rule 203(m)-1(d)(8).

attributed to $150 million of private fund assets.[84]

d. *Annual Report.* An adviser relying on the private fund adviser exemption must annually file a report on Form ADV to the SEC [85] and is subject to examination. Other provisions of the Act and SEC rules applicable only to registered advisers do not apply. The SEC refers to these advisers as "exempt reporting advisers."

7. *Venture Capital Advisers.* Available to an adviser that solely advises one or more "venture capital funds" as defined by SEC rule (regardless of the amount of assets managed).[86]

a. *Definition.* To qualify as a "venture capital fund," a fund must be a "private fund"[87] that:

(i) represents to investors that the fund pursues a venture capital strategy;[88]

(ii) does not provide investors with redemption rights;[89]

(iii) holds no more than 20% of the fund's assets in non-"qualifying investments" (excluding cash and certain short-term holdings)

Qualifying investment means generally directly acquired investments in equity securities of private companies (generally, companies that at the time of investment have not made a public offering) and that do not incur leverage or borrow in connection with the venture capital fund investment and distribute proceeds of such borrowing to the fund (*i.e.*, have not been acquired in a leveraged buy-out transaction); and

(iv) does not borrow (or otherwise incur leverage) more than 15% of the fund's assets, and then only on a short-term basis (*i.e.*, for no more than 120-days).[90]

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84 Rule 203(m)-1(b)(1) and (2). The term "place of business" has the same meaning as in the exemption for foreign private advisers, discussed above. *See* Section III. B. 3. of this outline. Rule 203(m)-1(d)(2).

85 Rule 204-2. The report must be filed within 60 days of relying on the private fund adviser exemption. Only portions of Form ADV must be completed. General Instruction 13 to Form ADV. An exempt reporting adviser is not required to deliver a brochure to its clients. General Instruction 3 to Form ADV.

86 Section 203(l) of the Advisers Act (added by the Dodd-Frank Act). The SEC adopted rule 203(l)-1 on June 22, 2011 to implement the section. *See* Release 3222, *supra* note 68.

87 Rule 203(l)-1(a)(5). In addition, the fund cannot be registered under the Investment Company Act or have elected to be treated as a business development company as defined by that Act. Rule 203(l)-1(a)(5).

88 Rule 203(l)-1(a)(1).

89 Rule 203(l)-1(a)(4) (the rule permits exceptions in extraordinary circumstances).

90 Rule 203(l)-1 contains a grandfathering provision for certain private funds that have sold their initial interests in the fund by December 31, 2010, provided that they have represented to their investors that

b. *Non-U.S. Advisers.* The exemption is available to a non-U.S. adviser, but (unlike the private fund adviser exception) such an adviser may not disregard its non-U.S. advisory activities.[91] Thus, all of an adviser's clients, including non-U.S. clients, must be venture capital funds.[92]

c. *Annual Reporting.* An adviser relying on the venture capital adviser exemption must annually file a report on Form ADV to the SEC, [93] and is subject to examination. Other provisions of the Act and SEC rules applicable only to registered advisers do not apply. The SEC also refers to these advisers as "exempt reporting advisers."

8. *Advisers to Small Business Investment Companies ("SBICs").* SBICs, licensed by the Small Business Administration, are privately owned and managed investment firms that provide venture capital to small businesses from the SBIC's own capital and from funds the SBIC is able to borrow at favorable rates through the federal government.[94]

IV. Who Must Register Under the Advisers Act?

A. The Advisory Firm

Although many individuals who are employed by advisers fall within the definition of "investment adviser," the SEC generally does not require those individuals to register as advisers with the SEC. Instead, the advisory firm must register with the SEC. The adviser's registration covers its employees *and* other persons under its control, provided that their advisory activities are undertaken on the adviser's behalf.[95]

B. Affiliates

1. *Integration.* The SEC staff takes the view that advisers and their affiliates cannot circumvent the disclosure and other requirements of the Act by separately registering under the Act if they are operationally integrated, *e.g.*, have the same personnel, capital structures, and investment decision-making functions.[96]

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they pursue a venture capital strategy and that they do not issue any interests to any person after July 21, 2011.

91 Release 3222, *supra* note 68.

92 Rule 203(l)-1 contains a note the effect of which is to permit a non-U.S. adviser to treat a foreign fund it advises as a "private fund" even if the fund does not meet the Act's definition of a private fund because it is not relying on a statutory exemption from the Investment Company Act, but is rather relying on the lack of jurisdiction of the U.S. Release 3222, *supra* note 68.

93 Rule 204-2. *See supra* note 85 for a summary of reporting requirements.

94 Section 203(b)(7) (added by the Dodd-Frank Act).

95 Investment Advisers Act Release No. 688 (July 12, 1979) (persons associated with registered adviser need not separately register as investment advisers solely as a result of their activities as associated persons). *See also Kevin J. Hughes*, SEC Staff No-Action Letter (Dec. 7, 1983).

96 The determination of whether an advisory business of two separately formed affiliates may be required to be integrated is based on the facts and circumstances. Release 3222, *supra* note 68. *See Richard*

For example, an adviser managing $200 million of private fund assets could not simply reorganize as two separate advisers each of which purported to rely on the private fund adviser exemption from registration.[97]

2. *Participating Non-U.S. Affiliates.* The SEC staff takes the view that, under certain conditions, a non-U.S. adviser (a "participating affiliate") does not have to register under the Act if it provides advice to U.S. persons through a registered affiliate.[98] The conditions that must be satisfied include the following:

   a. an unregistered adviser and its registered affiliate must be separately organized;

   b. the registered affiliate must be staffed with personnel (located in the U.S. or abroad) who are capable of providing investment advice;

   c. all personnel of the participating affiliate involved in U.S. advisory activities must be deemed "associated persons"[99] of the registered affiliate; and

   d. the SEC must have adequate access to trading and other records of the unregistered adviser and to its personnel to the extent necessary to enable the SEC to monitor and police conduct that may harm U.S. clients or markets.[100]

   The Commission affirmed these staff positions in the context of the private adviser exemptions.[101]

3. *Joint Registration of Affiliates.*

   a. *Special Purpose Vehicles.* The SEC staff takes the position that a special purpose vehicle ("SPV") set up by a registered investment adviser to serve as the general partner of a pooled investment vehicle (*e.g.*, a hedge fund) does not have to separately register as an investment adviser if all of the activities of the SPV are subject to the registered adviser's supervision and control,[102] its employees are

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Ellis, SEC Staff No-Action Letter (Sept. 17, 1981); *Kenneth Levanthal*, SEC Staff No-Action Letter (Feb. 7, 1983). *See also Price Waterhouse*, SEC Staff No-Action Letter (Nov. 22, 1988).

97 Release 3222, *supra* note 68, at Section II.D.

98 *See Uniao de Bancos de Brasilerios, S.A.*, SEC Staff No-Action Letter (July 28, 1992); *Mercury Asset Management*, SEC Staff No-Action Letter (Apr. 16, 1993); *Kleinwort Benson Investment Management Ltd.*, SEC Staff No-Action Letter (Dec. 15, 1993); *Murray Johnston Holdings Ltd.*, SEC Staff No-Action Letter (Oct. 7, 1994). *See also* Section II. C. of Release 3222 and Section III. B. 3 of this outline regarding the exemption for foreign private advisers.

99 *See* Section V. A. 1 of this outline for the definition of "person associated with an investment adviser."

100 *See id.*

101 Release 3222, *supra* note 68, at Section II.D.

102 For guidance regarding application of the staff's position with respect to directors of an SPV that are independent of the investment adviser, *see American Bar Association Subcommittee on Hedge Funds*, SEC Staff Letter (Jan. 18, 2012) ("ABA Letter 2012"), Question 3, *available at* http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm.

treated as "supervised persons" of the registered adviser and reported as such on its Form ADV, and the SPV is subject to examination by the SEC.[103] The SEC staff takes the view that this analysis is not limited to a registered adviser with a single SPV.[104]

b. *Multiple Entities in Control Relationships.* The SEC staff has taken the position that an investment adviser may file (or amend) a single Form ADV on behalf of itself and each other adviser that is under common control with the filing adviser where the filing adviser and each relying adviser collectively conduct a "single advisory business."[105]

V. How Does an Investment Adviser Register Under the Advisers Act?

A. Procedure

Applicants for registration under the Act must file Form ADV with the SEC. Within 45 days the SEC must grant registration or institute an administrative proceeding to determine whether registration should be denied.

1. *Denial of Registration.* The SEC may deny registration if the adviser is subject to a "Statutory Disqualification," that is, if the adviser or any "person associated with the adviser" makes false or misleading statements in its registration application, has within the past 10 years been convicted of a felony, or if it has been convicted by a court or found by the SEC to have violated a securities-related statute or rule, or have been the subject of a securities-related injunction, or similar legal action.[106]

   Person Associated with An Investment Adviser. These include employees (other than clerical employees) of the advisers as well as any persons who directly or indirectly control the investment adviser or are controlled by the adviser.[107] The SEC can deny registration if, for example, the parent company of an adviser has been convicted of securities fraud even if the adviser and its employees have not.

   Non-U.S. Based Offenses. Statutory Disqualifications include convictions in

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103 *American Bar Association Subcommittee on Private Entities*, SEC Staff Letter (Dec. 8, 2005) ("ABA Letter 2005"), Question G1, *available at* http://www.sec.gov/divisions/investment/noaction/aba120805.htm.

104 ABA Letter 2012, Question 2. Similarly, under certain circumstances, the staff has indicated that an exempt reporting adviser to which a private fund's day-to-day management responsibility has been delegated may satisfy the Form ADV reporting obligations of one or more special purpose entities. *See* "FAQs" regarding Reporting to the SEC as an Exempt Reporting Adviser ("ERA FAQs") *available at* http://www.sec.gov/divisions/investment/iard/iardfaq.shtml#exemptreportingadviser.

105 *See id.* Question 4 (outlining the circumstances under which a filing adviser and one or more relying advisers would, in the staff's view, collectively conduct a single advisory business absent other factors suggesting that they conduct different businesses). Likewise, under certain circumstances, the staff has indicated that an exempt reporting adviser may satisfy the Form ADV reporting obligations of one or more special purpose entities under its control. *See* ERA FAQs.

106 Sections 203(c)(2) and (e).

107 Section 202(a)(17).

non-U.S. courts, and by findings of violations by "foreign financial regulatory authorities" enforcing non-U.S. laws.[108]

2. *Qualifications.* There are no "fit and proper" or educational requirements for registration as an investment adviser, although certain employees of the adviser may have to pass securities examinations in the states in which they have a principal place of business. Instead, advisers must disclose to clients the background and qualifications of certain of their personnel.[109]

B. Form ADV

Form ADV sets forth the information that the SEC requires advisers to provide in an application for registration. Once registered, an adviser must update the form at least once a year, and more frequently if required by instructions to the form.[110] Form ADV consists of two parts.[111]

1. *Part 1.* Part 1 is primarily for SEC use. It requires information about the adviser's business, ownership, clients, employees, business practices (especially those involving potential conflicts with clients), and any disciplinary events of the adviser or its employees. The SEC uses information from this part of the form to make its registration determination and to manage its regulatory and examination programs. Part 1 is organized in a check-the-box, fill-in-the-blank format.

   On June 22, 2011, the SEC amended Part 1A to expand the information collected, primarily from advisers to hedge funds and other private funds in order to improve the SEC's ability to oversee registered advisers. Amended Part 1A requires advisers to provide additional information about three areas of their operations: (i) additional information about private funds they advise; (ii) expanded data provided by advisers about their advisory business (including the types of clients they have, their employees, and their advisory activities), as well as about their business practices that may present significant conflicts of interest; (iii) additional information about advisers' non-advisory activities and their financial industry affiliations.[112]

2. *Part 2.* Amended in 2010, Part 2 is divided into Part 2A and Part 2B and sets forth information required in client brochures and brochure supplements.[113]

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108 Sections 203(c)(2) and (e). Non-U.S. based offenses were added to section 203(e) in 1990 by the International Securities Enforcement Cooperation Act of 1990, Pub. L. No. 101-550, 104 Stat. 2713 (Nov. 15, 1990).

109 Form ADV, Part 2B.

110 Rule 204-1(a).

111 Both Part 1 and Part 2A of the Form ADV are filed by registered advisers through the IARD system and are available to the public on the Investment Adviser Public Disclosure Website at http://www.adviserinfo.sec.gov/(S(hdqosw4svnoutoxsmgo4mizx))/IAPD/Content/IapdMain/iapd_SiteMap.aspx.

112 Release 3221, *supra* note 46.

113 On July 28, 2010, the SEC adopted amendments to Part 2 of Form ADV. Investment Advisers Act Release No. 3060 (July, 2010), *available at* http://www.sec.gov/rules/final/2010/ia-3060.pdf ("Part 2

Brochure Part 2A requires an adviser to prepare a narrative "brochure" that includes plain English disclosures of, among other things, the adviser's business practices, investment strategies, fees, conflicts of interest, and disciplinary information.[114] Part 2B requires an adviser to prepare a "brochure supplement" that contains information about each advisory employee that provides investment advice to its clients, including her educational background, business experience, other business activities, and disciplinary history. To satisfy the "brochure rule" (discussed below),[115] the adviser must deliver the brochure (and updates to that brochure) to its clients annually and the brochure supplement about a supervisory employee to a client at the time the employee begins to provide advisory services to that client.[116] In addition, the adviser must file its brochure, but not its brochure supplement, with the SEC to satisfy its registration requirements.[117]

C. Electronic Filing

All applications for registration as an adviser with the SEC must be submitted electronically through an Internet-based filing system called the Investment Adviser Registration Depository ("IARD").[118] The IARD is operated by the Financial Industry Regulatory Authority ("FINRA"), the broker-dealer self-regulator (formerly, NASD).[119]

D. Public Availability

All current information from advisers' Form ADVs filed with the SEC is publicly available through an SEC web-site: www.adviserinfo.sec.gov.

E. Withdrawal of Registration

Advisers withdraw from registration by filing Form ADV-W.[120] An adviser may withdraw from registration because it: (i) ceases to be an investment adviser; (ii) is entitled to an exception from the registration requirements; or (iii) no longer is eligible for SEC registration (*e.g.*, it no longer has the requisite amount of assets

Adopting Release"). For staff responses to frequently asked questions about the amended Part 2, visit the SEC's website at http://www.sec.gov/divisions/investment/form-adv-part-2-faq.htm ("Part 2 FAQs").

114 Prior to the 2010 amendments, Part II of Form ADV was in a check-the-box, fill-in-the-blank format.

115 Rule 204-3.

116 Rule 204-3(b)(3). For specific delivery requirements under the brochure rule, see Section VI. B. 12 below.

117 Rule 203-1(a); Rule 204-1(b)(1).

118 Rule 203-1(b). FINRA charges advisers filing fees to defray the cost of maintaining and operating the IARD. To pay the fees, advisers must establish and fund an account with FINRA before making a filing. A fee schedule is available at www.sec.gov/divisions/investment/iard/iardfee.shtml.

119 Rule 204-1(b). For information about electronic filing by advisers, *see* www.sec.gov/iard. FINRA does not act as a self-regulatory organization with respect to investment advisers.

120 Rule 203-2. Form ADV-W filings are made electronically through the IARD, and are effective immediately. There are no filing fees for Form ADV-W.

under management).[121] The SEC also has the authority under section 203(f) of the Advisers Act to revoke the registration of an adviser under certain enumerated circumstances.

F. Successor Registrations

An unregistered person that assumes and continues the business of a registered investment adviser (which then ceases to do business) may rely on the registration of the investment adviser by filing an application for registration within 30 days of the succession.[122]

VI. What Are the Requirements Applicable to a Registered Investment Adviser?

The Advisers Act does not provide a comprehensive regulatory regime for advisers, but rather imposes on them a broad fiduciary duty to act in the best interest of their clients. As the Commission explained:

> Unlike the laws of many other countries, the U.S. federal securities laws do not prescribe minimum experience or qualification requirements for persons providing investment advice. They do not establish maximum fees that advisers may charge. Nor do they preclude advisers from having substantial conflicts of interest that might adversely affect the objectivity of the advice they provide. Rather, investors have the responsibility, based on disclosure they receive, for selecting their own advisers, negotiating their own fee arrangements, and evaluating their advisers' conflicts.[123]

There are five types of requirements on an adviser: (i) fiduciary duties to clients; (ii) substantive prohibitions and requirements; (iii) contractual requirements; (iv) recordkeeping requirements; and (v) administrative oversight by the SEC, primarily by inspection.

A. Fiduciary Duties to Clients

Fundamental to the Act is the notion that an adviser is a fiduciary. As a fiduciary, an adviser must avoid conflicts of interest with clients and is prohibited from overreaching or taking unfair advantage of a client's trust. A fiduciary owes its clients more than mere honesty and good faith alone. A fiduciary must be sensitive to the conscious and unconscious possibility of providing less than disinterested advice, and it may be faulted even when it does not intend to injure a client and even if the client does not suffer a monetary loss.[124] The landmark

121 Before withdrawing from registration, an adviser must arrange for the preservation of records it is required to keep under the Act. Rule 204-2(f).

122 Section 203(g). *See* Instruction 4 to Part 1A of Form ADV; *Registration of Successors to Broker-Dealers and Investment Advisers*, Investment Advisers Act Release No. 1357 (Dec. 28, 1992) (the provision in rule 203-1 referred to in Release 1357 that addressed successions was moved by the SEC to Instruction 4 to Form ADV in 2000). A succession resulting from a change in the place or form of organization, or composition of a partnership, *i.e.*, a succession that does not involve a change of control, may be completed by amending the predecessor's Form ADV promptly after the succession. *Id.*

123 *See Amendments to Form ADV*, Investment Advisers Act Release No. 2711 (Mar. 3, 2008).

124 *SEC v. Capital Gains Research Bureau, supra* note 2, at 191-192.

court decision defining the duties of a fiduciary is Justice Cardozo's opinion in *Meinhard v. Salmon,* in which he explains that:

> Many forms of conduct permissible in the workaday world for those acting at arm's length are forbidden by those bound by fiduciary ties. A fiduciary is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[125]

These concepts are embodied in the anti-fraud provisions of the Advisers Act. As the Supreme Court stated in *SEC v. Capital Gains Research Bureau, Inc.*, its seminal decision on the fiduciary duties of an adviser under the Act:

> [t]he Investment Advisers Act of 1940 reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.[126]

The duty is not specifically set forth in the Act, established by SEC rules, or a result of a contract between the adviser and the client (and thus it cannot be negotiated away). Rather, fiduciary duties are imposed on an adviser by operation of law because of the nature of the relationship between the two parties.[127] It is made enforceable by section 206 of the Act,[128] which contains the Act's anti-fraud provisions, and incorporated indirectly into the Act in various provisions and disclosure requirements discussed below.[129]

Several obligations flow from an adviser's fiduciary duties.

1. *Full Disclosure of Material Facts*. Under the Act, an adviser has an affirmative obligation of utmost good faith and full and fair disclosure of all facts material to the client's engagement of the adviser to its clients, as well as a duty to avoid misleading them.[130] Accordingly, the duty of an investment adviser to refrain from fraudulent conduct includes an obligation to disclose material facts to its clients whenever failure to do so would defraud or operate as a fraud or deceit upon any client.

   Conflicts of Interest. This disclosure of material facts is particularly pertinent whenever the adviser is faced with a conflict—or a potential

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125 164 N.E. 545, 546 (N.Y. 1928).

126 *SEC v. Capital Gains Research Bureau, supra* note 2, at 190-192.

127 *See In the Matter of Arleen W. Hughes*, Exchange Act Release No. 4048 (Feb 18, 1948).

128 *Transamerica Mortgage Advisors v. Lewis,* 444 U.S. 11 (1979) ("[T]he Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.").

129 *See Morris v. Wachovia Securities, Inc.,* 277 F. Supp. 2d 622 (E.D. Va. 2003) ("§206(2) is more than an anti-fraud provision because it establishes fiduciary duties for investment advisers."). The scope of the fiduciary duties is determined by reference to federal court and administrative decisions rather than state common law analogies. *Laird v. Integrated Resources, Inc.,* 897 F.2d 826 (5th Cir. 1990) ("[B]ecause state law is not considered, uniformity is promoted.").

130 *See In the Matter of Arleen W. Hughes, supra* note 127.

conflict— of interest with a client. As a general matter, the SEC has stated that the adviser must disclose all material facts regarding the conflict so that the client can make an informed decision whether to enter into or continue an advisory relationship with the adviser, or take some action to protect himself or herself against the conflict.[131]

Disciplinary Events and Precarious Financial Condition. The SEC requires a registered adviser to disclose to clients and prospective clients material facts about:

a. a financial condition of the adviser that is reasonably likely to impair the adviser's ability to meet contractual commitments to clients;[132] and

b. certain disciplinary events of the adviser (and certain of its officers) occurring within the past 10 years, which are presumptively material.[133]

2. *Suitable Advice.* Advisers owe their clients a duty to provide only suitable investment advice. This duty generally requires an adviser to make a reasonable inquiry into the client's financial situation, investment experience and investment objectives, and to make a reasonable determination that the advice is suitable in light of the client's situation, experience and objectives.[134]

3. *Reasonable Basis for Recommendations.* An adviser must have a

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131 Part 2 Adopting Release, *supra* note 113. *See also SEC v. Capital Gains Research Bureau*, *supra* note 2, at 191-192 ("The Investment Advisers Act of 1940 thus reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship, as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.").

132 Item 18 of Part 1A, Form ADV. This requirement is applicable to advisers that have discretionary authority with client accounts, or have custody of client assets, or require or solicit prepayment of more than $1,200 in fees per *client*, six months or more in advance.

133 Form ADV: Item 11 of Part 1A; Item 9 of Part 2A, and Item 3 of Part 2B.

134 *See Suitability of Investment Advice Provided by Investment Advisers,* Investment Advisers Act Release No. 1406 (Mar. 16, 1994). In that release, the SEC proposed a rule under the Act's anti-fraud provisions requiring advisers give clients only suitable advice. Although the rule was never adopted, SEC staff believes that the rule would have codified existing suitability obligations of advisers and, as a result, the proposed rule reflects the current obligation of advisers under the Act. Suitability obligations do not apply to impersonal investment advice, and compliance with the obligation is evaluated in the context of a client's overall portfolio. *Id.* "Thus, inclusion of some risky securities in the portfolio of a risk-averse client may not necessarily be unsuitable." *Id.* The SEC has instituted enforcement actions against advisers that provided unsuitable investment advice. *See In the Matter of George E. Brooks & Associates, Inc.*, Investment Advisers Act Release No. 1746 (Aug. 17, 1998) (adviser failed to appropriately diversify, and effected unsuitable trades of speculative high risk stocks in, the discretionary accounts of customers with conservative investment objectives, many of whom were elderly and had little investment experience); *In the Matter of Philip A. Lehman,* Investment Advisers Act Release No. 1831 (Sept. 22, 1999) (alleging adviser recommended risky investment for customer's individual retirement account, despite customer's conservative investment objective and age).

reasonable, independent basis for its recommendations.[135]

4. *Best Execution.* Where an adviser has responsibility to direct client brokerage, it has an obligation to *seek* best execution of clients' securities transactions.[136] In meeting this obligation, an adviser must seek to obtain the execution of transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances.[137] In assessing whether this standard is met, an adviser should consider the full range and quality of a broker's services when placing brokerage, including, among other things, execution capability, commission rate, financial responsibility, responsiveness to the adviser, and the value of any research provided.[138]

   Interpositioning. An adviser will generally not obtain best execution if it interposes a broker that does not make a market in the security when it could have avoided the unnecessary commission payments by dealing directly with market makers.[139]

   Directed Trades. An adviser is relieved of this obligation when a client directs the adviser to use a particular broker. An adviser may, however, be required to make additional disclosure to clients when it receives some benefit from the direction of the trade.[140]

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135 *In the Matter of Alfred C. Rizzo*, Investment Advisers Act Release No. 897 (Jan 11, 1984) (investment adviser lacked a reasonable basis for advice and could not rely on "incredible claims" of issuer); *In the Matter of Baskin Planning Consultants, Ltd.*, Investment Advisers Act Release 1297 (Dec. 19, 1991) (adviser failed adequately to investigate recommendations to clients).

136 *In the Matter of Kidder Peabody & Co., Inc.*, Investment Advisers Act Release No. 232 (Oct. 16, 1968). *See also* rule 206(3)-2(c) (acknowledging adviser's duty of best execution of client transactions).

137 This obligation is different from a broker-dealer's best execution obligation, which typically focuses on the price at which an order is executed and does not consider the broker's compensation, whereas an adviser's duty requires it to consider the total transaction cost to its client. The SEC has brought enforcement actions against advisers alleging failure to seek best execution. *See, e.g., In the Matter of Renberg Capital Management, Inc.*, Investment Advisers Act Release No. 2064 (Oct 1, 2002); *In the Matter of Portfolio Advisory Services, LLC*, Investment Advisers Act Release. No. 2038 (June 30, 2002).

138 *See Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters,* Exchange Act Release No. 23170 (Apr. 23, 1986) ("1986 Soft Dollar Release"). To fulfill this duty, an investment adviser should "periodically and systematically" evaluate the execution it is receiving for clients. *Id.* The scope of the duty evolves as changes occur in the market that give rise to improved execution, including opportunities to trade at more reasonable prices. *See, e.g., Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.,* 135 F.3d 266, 270-271 (3d Cir. 1998). *See also, In the Matter of Jamison, Eaton & Wood, Inc.,* Investment Advisers Act Release No. 2129 (May 15, 2003); *In the Matter of Portfolio Advisory Services, LLC, supra* note 137.

139 *In the Matter of Delaware Management Company, Inc.*, Securities Exchange Act Release No. 8128 (July 19, 1967).

140 *See In the Matter of Mark Bailey & Co.*, Investment Advisers Act Release No. 1105 (Feb. 24, 1988) (adviser failed to disclose that it did not negotiate commissions on directed trades, and failed to disclose that the adviser would be in a better position to negotiate commissions in bunched transactions for non-directed trades, and violated anti-fraud provisions of Advisers Act); *Jamison, Eaton & Wood, Inc., supra* note 138.

Use of Brokerage Affiliate. The Act does not prohibit advisers from using an affiliated broker to execute client trades. However, use of an affiliate involves a conflict of interest that must be disclosed to client.[141] For example, use of an affiliated broker may give the adviser incentive to "churn" the account.

Soft Dollars. Section 28(e) of the Exchange Act provides a safe harbor from liability for breach of fiduciary duties when advisers purchase brokerage and research products and services with client commission dollars under specified circumstances. In July 2006, the SEC issued a revised interpretation as to the scope of the safe harbor.[142]

Under section 28(e), an adviser that exercises investment discretion may lawfully pay commissions to a broker at rates higher than those offered by other brokers, as long as the services provided to the adviser by the broker-dealer: (i) are limited to "research" or "brokerage;" (ii) constitute lawful and appropriate assistance to the adviser in the performance of its investment decision-making responsibilities, and (iii) the adviser determines in good faith that the commission payments are reasonable in light of the value of the brokerage and research services received.

a. *Research Services*. "Research" services generally include the furnishing of advice, analyses, or reports concerning securities, portfolio strategy and the performance of accounts, which means the research must reflect the expression of reasoning or knowledge relating to the statutory subject matter bearing on the investment decision-making of the adviser. The SEC does not believe that products or services with "inherently tangible or physical attributes" meet this test.

    (i) Products or services generally falling within the safe harbor include traditional research reports, market data, discussions with research analysts, meetings with corporate executives, software that provides analysis of securities, and publications (other than mass-marketed publications).

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141 *Folger Nolan Fleming Douglas Capital Management, Inc.*, Investment Advisers Act Release No. 2639 (Aug. 23, 2007) (adviser entered into agreements with clients to direct trades to affiliated broker without disclosing commission rates were twice as high as non-directed trades). *See also* Investment Advisers Act Release 1092, *supra* note 3 (if an investment adviser recommends that a client effect transactions through its broker-dealer employer, the anti-fraud provisions of the Advisers Act require that the adviser make full disclosure of the nature and extent of all adverse interests, including the amount of any compensation the advisers will receive from its broker-dealer employer in connection such transactions); *Don P. Matheson*, SEC Staff No-Action Letter (Aug. 2, 1976) (investment advisers that are also broker-dealers or registered representatives have a duty to inform their investment advisory clients of their ability to seek executions of transactions recommended through other broker-dealers firms); *David P. Atkinson*, SEC Staff No-Action Letter (Aug. 1, 1977).

142 *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Release No. 34-54165 (July 18, 2006) ("2006 Soft Dollar Release"), *available at* http://www.sec.gov/rules/interp/2006/34-54165.pdf. The release superseded parts (but not all) of the 1986 Soft Dollar Release. In particular, the 2006 Soft Dollar Release does not replace Section IV of the 1986 Release, which discusses an investment adviser's disclosure obligations.

(ii) Products or services not within the safe harbor include computer hardware, telephone lines, peripherals; salaries, rent, travel, entertainment, and meals; software used for accounting, recordkeeping, client reporting, or other administrative functions; and marketing seminars and other marketing costs.

(iii) Where a product or service has uses both inside and outside the safe harbor, the SEC believes that an adviser should make a reasonable allocation of the cost of the product or service according to its use and keep adequate books and records concerning allocations so as to be able to make the required good faith showing.[143]

b. *Brokerage Services.* "Brokerage" generally includes activities related to effecting securities transactions and incidental functions. According to the SEC, brokerage begins when the order is transmitted to the broker-dealer and ends when funds or securities are delivered to the client account.[144]

c. *Commissions.* The SEC interprets the safe harbor of section 28(e) as being available for research obtained in relation to commissions on agency transactions, and certain riskless principal transactions.[145]

d. *Disclosure Obligations.* Advisers are required to disclose to clients any soft dollar arrangements, regardless of whether the arrangements fall within the section 28(e) safe harbor.[146] Failure to disclose the receipt of products or services purchased with client commission dollars may constitute a breach of fiduciary duties and/or violation of specific provisions of the Advisers Act and other federal laws.[147]

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143 *See id.*, at Section F, n. 148.

144 *Id.*

145 Exchange Act Release No. 45194 (Dec. 27, 2001) ("Release No. 45194"), *available at* http://www.sec.gov/rules/interp/interparchive/interparch2001.shtml. In Release No. 45194, the SEC concluded with respect to riskless principal transactions that "[t]he term 'commission' in Section 28(e) . . . include[s] a markup, markdown, commission equivalent or other fee paid by a managed account to a dealer for executing a transaction where the fee and transaction price are fully and separately disclosed on the confirmation and the transaction is reported under conditions that provide independent and objective verification of the transaction prices subject to self-regulatory oversight." The SEC staff had previously interpreted the safe harbor as being available only to agency transactions. *Letter to Charles Lerner, Esq., Director of Enforcement, Pension and Welfare Benefit Administration, U.S. Department of Labor, from Richard Ketchum, Director, Division of Market Regulation, SEC* (July 25, 1990).

146 Form ADV, the registration form for advisers, requires that advisers disclose soft dollar arrangements. *See* Form ADV, Part 1A, Item 8; Part 2A, Item 12A.1. *See also SEC Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds* (Sept. 22, 1998), *available at* http://www.sec.gov/news/studies/softdolr.htm.

147 *See, e.g., In the Matter of S Squared Technology Corporation*, Investment Advisers Act Release No. 1575 (Aug. 7, 1996) (adviser's failure to disclose its receipt of benefits in exchange for benefits received in exchange for direction of client brokerage violated section 206 of the Act); *In the Matter of Schultze Asset Management*, Investment Advisers Act Release No. 2633 (Aug. 15, 2007) (adviser

5. *Proxy Voting.* The SEC has stated that an adviser delegated authority to vote client proxies has a fiduciary duty to clients to vote the proxies in the best interest of its clients and cannot subrogate the client's interests to its own.[148]

B. Substantive Requirements

The Act contains other, more specific prohibitions designed to prevent fraud. In addition, the SEC has adopted several anti-fraud rules, which apply to advisers registered with the SEC.

1. *Client Transactions*

a. *Principal Transactions.* Section 206(3) of the Act prohibits an adviser, acting as principal for its own account, from knowingly selling any security to or purchasing any security from a client for its own account, without disclosing to the client in writing the capacity in which it (or an affiliate[149]) is acting and obtaining the client's consent before the completion of the transaction.[150] The SEC staff has stated that notification and consent must be obtained separately for each transaction, *i.e.,* a blanket consent for transactions is not sufficient.[151]

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misrepresented to clients that it would restrict its use of soft dollars to cover only those expenses covered by section 28(e) when it used them to pay for operating expenses).

148 *Proxy Voting by Investment Advisers*, Investment Advisers Act Release No. 2106 (Jan. 31, 2003), *available at* http://www.sec.gov/rules/final/ia-2106.htm. In this release, the SEC adopted rule 206(4)-6, which requires, among other things, each registered investment adviser that has voting authority over client securities to adopt and implement policies and procedures reasonably designed to ensure that client securities are voted in the best interest of clients. The SEC has instituted enforcement action against an adviser that failed to disclose to clients its conflicts before voting their shares in a hotly contested proxy fight. *In the Matter of Deutsche Asset Management, Inc.*, Investment Advisers Act Release No. 2160 (Aug. 19, 2003). *See also* Section VI. B. 6 of this outline.

149 The SEC has applied section 206(3) not only to principal transactions engaged in or effected by any adviser, but also when an adviser causes a client to enter into a principal transaction that is effected by a broker-dealer that controls, is controlled by, or is under common control with, the adviser. *Interpretation of Section 206(3) of the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1732 (July 17, 1998)("Release 1732"), at n.3, *available at* http://www.sec.gov/rules/interp/interparchive/interparch1998.shtml. The SEC has instituted enforcement actions when advisers have effected principal transactions through affiliates without complying with section 206(3), *see, e.g., In the Matter of Calamos Asset Management,* Investment Advisers Act Release No. 1589 (Sept. 30, 1996), including "riskless principal" transactions; *In the Matter of Rothschild Investment Corporation*, Investment Advisers Act Release No. 1714 (Apr. 13, 1998); *In the Matter of Concord Investment Co.*, Investment Advisers Act Release No. 1585 (Sept. 27, 1996).

150 Section 206(3). The SEC interprets "completion of the transaction" to mean by settlement of the transaction. Release 1732, *supra* note 149, *available at* http://www.sec.gov/rules/interp/ia-1732.htm. But the SEC believes that, in order for post-execution, pre-settlement consent to comply with section 206(3), the adviser must provide both sufficient disclosure for a client to make an informed decision, and the opportunity for the client to withhold consent. *Id.* While the notice must be in writing, the SEC staff has stated that oral consent is sufficient under the Act. *Dillon, Reed & Co.*, SEC Staff No-Action Letter (Aug. 6, 1975). The notice and consent provisions of section 206(3) do not apply if the adviser is giving only impersonal advisory services. Rule 206(3)-1.

151 *Opinion of Director of Trading and Exchange Division*, Investment Advisers Act Release No. 40 (Jan. 5, 1945). The SEC has instituted enforcement actions against investment advisers for violating section

Pooled Investment Vehicles. The SEC staff has stated that section 206(3) may apply to client transactions with a pooled investment vehicle in which the adviser or its personnel may have interests depending on the facts and circumstances, including the extent of the interests held by the adviser and its affiliates.[152] The SEC staff, however, believes that section 206(3) does not apply to a transaction between a client account and a pooled investment vehicle of which the investment adviser and/or its controlling persons, in the aggregate, own 25% or less.[153]

Statutory Exception. The restrictions on principal transactions do not apply to transactions by a client where the adviser (or an affiliate) is also a broker-dealer, but "is not acting as an investment adviser with respect to the trade," *e.g.*, it has not given the advice to buy or sell the security.[154]

Updated →

Rule 206(3)-3T. The SEC has adopted a temporary rule, set to expire on December 31, 2014, that permits advisers that are also registered with the SEC as broker-dealers to comply with section 206(3) by providing oral (instead of written) notice of principal transactions so long as certain conditions are met.[155] Specifically, rule 206(3)-3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Act by, among other things:

(i) providing written prospective disclosure regarding the conflicts arising from principal trades;

(ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal transactions;

(iii) making certain disclosures either orally or in writing and

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206(3) when they entered into principal transactions with their clients using only prior blanket disclosures and consents. *See In the Matter of Stephens, Inc.*, Investment Advisers Act Release No. 1666 (Sept. 16, 1997); *In the Matter of Clariden Asset Management (New York) Inc.*, Investment Advisers Act Release No. 1504 (July 10, 1995).

152 ABA Letter 2005, *supra* note 103 at II.A.1. The SEC has instituted enforcement actions based on claims of violations of section 206(3) against advisers and their principals when the advisers effected transactions between their advisory clients and accounts in which the principals of the advisers held significant ownership interests. *See In the Matter of SEC v. Beacon Hill Asset Management, LLC, et al.*, Litigation Release No. 18950 (Oct. 28, 2004); *In the Matter of Gintel Asset Management, et al.*, Investment Advisers Act Release No. 2079 (Nov. 8, 2002).

153 *Gardner Russo & Gardner*, SEC Staff No-Action Letter (June 7, 2006).

154 Section 206(3) provides that the section's "prohibitions...shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction."

155 Rule 206(3)-3T. *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 (Sep. 24, 2007) (adopting rule 206(3)-3T), *available at* http://www.sec.gov/rules/final/2007/ia-2653.pdf; *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release 3522 (Dec. 20, 2012) (extending expiration date to Dec. 31, 2014), *available at* http://www.sec.gov/rules/final/2012/ia-3522.pdf.

obtaining the client's consent before each principal transaction;

(iv) sending to the client confirmation statements disclosing the capacity in which the adviser has acted and disclosing that the adviser informed the client that it may act in a principal capacity and that the client authorized the transaction; and

(v) delivering to the client an annual report itemizing the principal transactions.

With certain limited exceptions (for non-convertible investment-grade debt securities underwritten by the adviser or a person who controls, is controlled by, or is under common control with the adviser (a "control person")), the rule generally is not available for principal trades of securities issued or underwritten by the investment adviser or a control person of the adviser.[156]

Fiduciary Obligations. Compliance with the disclosure and consent provisions of section 206(3) or rule 206(3)-3T alone does not satisfy an adviser's fiduciary obligations with respect to a principal trade. The SEC has expressed the view that section 206(3) must be read together with sections 206(1) and (2) of the Act to require that the adviser disclose additional facts necessary to alert the client to the adviser's potential conflict of interest in the principal trade.[157]

b. *Agency Cross Transactions.* Section 206(3) also prohibits an adviser from knowingly acting as broker for both its advisory client and the party on the other side of the transaction without obtaining its client's consent before each transaction.[158]

Rule 206(3)-2. The SEC has adopted a rule permitting these "agency cross-transactions" without transaction-by-transaction disclosure if, among other things:

(i) the client has executed a written blanket consent after receiving full disclosure of the conflicts involved, which must be renewed each year;

(ii) the adviser provides a written confirmation to the client before the completion of each transaction providing, among other

156 The rule also requires that each account for which the adviser relies on the rule be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which it is a member.

157 Release 1732, *supra* note 149. *See also Rocky Mountain Financial Planning, Inc.*, SEC Staff No-Action Letter (Feb. 24, 1983) ("While section 206(3) of the Investment Advisers Act of 1940 requires disclosure of such interest and the client's consent to enter into the transaction with knowledge of such interest, the adviser's fiduciary duties are not discharged merely by such disclosure and consent. The adviser must have a reasonable belief that the entry of the client into the transaction is in the client's interest.").

158 Section 206(3). The SEC staff has expressed the view that the provisions of section 206(3) do not apply when the adviser/broker effects the trade without charging a commission or other fee. Release No. 1732, *supra* note 149.

things, the source and amount of any remuneration it received; and

(iii) the disclosure document and each confirmation conspicuously disclose that consent may be revoked at any time.[159]

c. *Cross-Trades.* Effecting cross-trades between clients (where a third-party broker is used) is not specifically addressed by the Act, but is subject to the anti-fraud provisions of the Act.[160] Cross-trades involve potential conflicts of interest (because the adviser could favor one client over another), and thus many advisers follow the methodology required by a rule under the Investment Company Act when one of the clients is an investment company.[161]

d. *Aggregation of Client Orders.* The SEC staff has stated that in directing orders for the purchase or sale of securities, an adviser may aggregate or "bunch" those orders on behalf of two or more of its accounts, so long as the bunching is done for the purpose of achieving best execution, and no client is systematically advantaged or disadvantaged by the bunching.[162]

Advisers that aggregate orders of securities face conflicts when they disaggregate the orders to client accounts since, for example, not all securities may have been acquired at the same price. Advisers should have procedures in place that are designed to ensure that the trades are allocated in such a manner that all clients are treated fairly and equitably.[163] For example, advisers can allocate orders based on a *pro rata*, rotational, or random basis.

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159 Rule 206(3)-2. The rule does not apply to a transaction when the adviser has discretionary authority to act for the purchaser and seller. Paragraph (c) of the rule admonishes advisers that the rule does not relieve them of the duty to act in the best interests of their clients, including the duty to obtain best price and execution for any transaction. *See Agency Cross Transactions for Advisory Clients,* Investment Advisers Act Release No. 589 (May 31, 1977) (adopting rule 206(3)-2).

160 *See* In *the Matter of Renberg Capital Management, Inc. and Daniel H. Renberg*, Investment Advisers Act Release No. 2064 (Oct. 1, 2002).

161 Rule 17a-7. Merely following the procedures set forth in rule 17a-7 may not satisfy an adviser's fiduciary obligations to clients. The staff has explained that it must be in the interest of both clients to enter into a cross trade and thus, for example, an adviser should not cause a client to enter into a cross-trade if it could obtain a better price in the markets. *Federated Municipal Funds*, SEC No-Action Letter (Nov. 20, 2006).

162 *Pretzel & Stouffer*, SEC Staff No-Action Letter (Dec. 1, 1995).

163 The SEC has instituted numerous enforcement actions against advisers that unfairly allocated client trades without making adequate disclosure. *See In the Matter of John McStay Investment Counsel, L.P*, Investment Advisers Act Release No. 2153 (July 31, 2003) (adviser failed to disclose change in its method of allocating initial public offerings among accounts to a method that favored mutual fund account); *In the Matter of McKenzie Walker Investment Management, Inc., et al.*, Investment Advisers Act Release No. 1571 (1996) (adviser allocated profitable trades to accounts charged a performance-based fee); *In the Matter of Nicholas-Applegate Capital Management*, Investment Advisers Act Release No. 1741 (Aug. 12, 1998) (adviser failed to supervise trader who allocated profitable trades to own personal account); *In the Matter of Ark Asset Management Co., Inc.*, Investment Advisers Act Release No. 2962 (Dec. 14, 2009) (adviser allocated profitable trades to the proprietary hedge fund accounts at the expense of the client accounts without disclosing this practice).

2. *Advertising.* The anti-fraud provisions of the Act apply with respect to both clients and *prospective* clients. The SEC has adopted rule 206(4)-1, which prohibits any adviser registered with the SEC from using any advertisement that contains any untrue statement of material fact or is otherwise misleading.[164]

Specific Restrictions. An advertisement may not:

a. use or refer to testimonials, which staff views as including any statement of a client's experience with, or endorsement of, an adviser;[165]

b. refer to past specific recommendations made by the adviser, unless the advertisement sets out a list of all recommendations made by the adviser during the preceding year;

c. represents that any graph, chart, or formula can, in and of itself, be used to determine which securities to buy or sell; and

d. refer to any report, analysis, or service as free, unless it really is.

Performance Advertising. Advertisements containing information about the performance of client accounts must not be misleading. The SEC staff considers an advertisement containing performance information misleading if it implies, or if a reader would infer from it, something about an adviser's competence or possible future investment results that would be unwarranted if the reader knew all of the facts.[166] Advisers registered with the SEC must maintain records substantiating any performance claimed in an advertisement.[167]

Definition of Advertisement. While no communications to clients may be misleading, the specific restrictions discussed above apply only to "advertisements" by advisers, which the SEC defines generally as communications (in writing or electronic form) to more than one person that offer advisory services.[168] The SEC staff does not believe that a written

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164 Rule 206(4)-1. *See also SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1104 (9th Cir. 1977) (an adviser's advertising "must be measured from the viewpoint of a person unskilled and unsophisticated in investment matters"); *In the Matter of Jesse Rosenblum*, Investment Advisers Act Release No. 913 (May 17, 1984) (an investment adviser's advertisement that contained materially misleading statements was "not cured by the disclaimers buried in the [smaller print] text [of the advertisement]").

165 For further discussion, *see DALBAR, Inc.,* SEC Staff No-Action Letter (Mar. 24, 1997).

166 *Edward F. O'Keefe*, SEC Staff No-Action Letter (Apr. 13, 1978); *Anametrics Investment Management*, SEC Staff No-Action Letter (May 5, 1977). *See also Clover Capital Management, Inc.*, SEC Staff No-Action Letter (Oct. 28, 1986).

167 Rule 204-2(a)(16). *See In the Matter of Warwick Capital Management, Inc.*, Initial Decision Release No. 327 (Feb. 15, 2007). ("Respondent blamed a series of dubious calamities for their inability to produce records that would support the inflated numbers and created after-the-fact documents concerning the inflated numbers.").

168 Rule 206(4)-1(b) defines advertisement for purposes of the rule as "[a]ny notice circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report or publication concerning securities, or (2) any graph, chart, formula or other device to be used in making any determination as to

communication by an adviser that does no more than respond to an unsolicited request by a client is an advertisement even if it received multiple requests for the same information, *e.g.*, in multiple RFPs.[169]

Use of Social Media. Use of social media to communicate with clients and prospective clients may implicate rule 206(4)-1.[170]

3. *Custody of Client Assets.* A registered adviser with custody of client funds or securities ("client assets") is required by rule 206(4)-2 to take a number of steps designed to safeguard those client assets.[171] These requirements were amended in December 2009.[172]

   a. *Definition of Custody.* Custody means "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them." An adviser has custody if an affiliate has custody of its client funds or securities in connection with advisory services it provides to clients.

      Custody includes:

      (i) Possession of client funds or securities;

      (ii) Any arrangement under which an adviser is permitted or authorized to withdraw client funds or securities (such as check-writing authority or the ability to deduct fees from client assets), and

      (iii) Any capacity that gives an adviser or its supervised person legal ownership of or access to client funds or securities (such as acting as general partner or trustee of a pooled investment vehicle).[173]

   b. *Qualified Custodians.* An adviser with custody must maintain client funds and securities with "qualified custodians" either under the client's name or under the adviser's name as agent or trustee for its clients. Qualified custodians are:

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when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities." A communication covered by the rule may be made to new clients or to existing clients where the purpose is to induce them to renew their advisory contract or subscription. *Spear & Staff*, 42 S.E.C. 549 (1965).

169 *Investment Counsel Association of America*, SEC Staff Letter (Mar. 1, 2004).

170 The SEC staff has made observations regarding advisers' use of social media. *Investment Adviser Use of Social Media*, National Examination Risk Alert, Vol. II, Issue 1 (Jan. 4, 2012), *available at* http://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf.

171 Rule 206(4)-2. The staff of the SEC's Division of Investment Management has published responses to "FAQs" (frequently asked questions) on the custody rule ("Custody Rule FAQs"), *available at* http://www.sec.gov/divisions/investment/custody_faq_030510.htm.

172 *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) ("Release 2968"), *available at* http://www.sec.gov/rules/final/2009/ia-2968.pdf.

173 Rule 206(4)-2(d)(2).

(i) broker-dealers, banks, savings associations, futures commission merchants, and

(ii) non-U.S. financial institutions that customarily hold financial assets for their customers, if the institutions keep the advisory assets separate from their own.

c. *Quarterly Account Statements.* The adviser must have a reasonable basis, after due inquiry, for believing that the qualified custodian sends quarterly account statements directly to the client.[174]

d. *Notification.* The adviser must notify the client as to where and how the funds or securities will be maintained, promptly after opening an account for the client and following any changes to this information.[175] If the adviser also sends its own account statements to clients, this notice and subsequent account statements from the adviser must contain a statement urging the client to compare account statements from the custodian with those from the adviser.[176]

e. *Surprise Examinations.* An adviser that has custody of client assets generally must undergo an annual surprise examination by an independent public accountant to verify the client's funds and securities.[177] One exception from this requirement is if it has custody *solely* because it has authority to deduct advisory fees directly from client accounts.[178]

Updated → f. *Pooled Investment Vehicles.* If the adviser is the general partner of a limited partnership (or holds a similar position with another form of pooled investment vehicle such as a hedge fund)[179]:

(i) the adviser is deemed to have complied with the annual surprise examination requirement and need not form a reasonable belief regarding delivery of account statements if the pool's financial statements are audited by an independent public accountant that is registered with, and subject to regular inspection by, the Public

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174 A common method of forming a reasonable belief acceptable to the SEC is receipt of a copy of an account statement sent to the client. Release No. 2968, *supra* note 172.

175 Notice need not be given if the client opens the account himself.

176 Rule 206(4)-2(a)(2).

177 The timing of exams must be irregular from year to year. Rule 206(4)-2(a)(4). *See also, In the Matter of Kaufman, Bernstein, et al.,* Investment Advisers Act Release No. 2194 (Nov. 20, 2003) (independent auditor began examination the same date each year). The accountant conducting the examination must file a certificate on Form ADV-E within 120 days of the time chosen by the accountant for the examination. Rule 206(4)-2(a)(4)(i). The SEC has issued guidance for accountants performing an examination pursuant to this rule. *See Commission Guidance Regarding Independent Public Accountant Engagements Performed Pursuant to Rule 206(4)-2 Under the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 2969 (Dec. 30, 2009).

178 Rule 206(4)-2(b)(3).

179 The SEC staff takes the position that a state-created 529 plan may be treated as a pooled investment vehicle for these purposes. *See Investment Company Institute*, SEC Staff No-Action Letter (Sept. 5, 2012).

Company Accounting Oversight Board ("PCAOB"),[180] and the audited statements are distributed to the pool's investors;[181] or

(ii) the qualified custodian must send quarterly account statements to each investor in the pool and the adviser must obtain a surprise examination of the pool's assets.[182]

g. *Adviser or "Related Person" as Custodian.[183]* If the adviser or its related person maintains client assets as the qualified custodian in connection with the adviser's advisory services, the adviser must:

(i) have an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB perform the required annual surprise examination, unless the related person is "operationally independent" of the adviser;[184] and

(ii) obtain, or receive from the affiliate, an annual report of the internal controls relating to the custody of client assets prepared by an independent public accountant that is registered with, and subject to regular inspection by, the PCAOB.[185]

4. *Use of Solicitors.* An adviser generally is prohibited by rule 206(4)-3 from paying a cash fee, directly or indirectly, to a third party (a "solicitor") unless it meets the requirements of the rule:

a. *Registered.* The adviser must be registered under the Act.

b. *Not Disqualified.* An adviser may not pay solicitation fees to a solicitor that would itself be subject to Statutory Disqualification as an investment adviser.[186]

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180 The audited financial statements must be prepared according to, or reconciled to, U.S. GAAP.

181 The audited financial statements must be distributed to investors within 120 days after the close of the pool's fiscal year. In 2006, the Division of Investment Management issued a letter indicating that it would not recommend enforcement action to the Commission under section 206(4) of the Act or rule 206(4)-2 against an adviser of a "fund of funds" relying on the annual audit provision of rule 206(4)-2 if the audited financial statements of the fund of funds are distributed to investors in the fund of funds within 180 days of the end of its fiscal year. *See ABA Committee on Private Investment Entities*, SEC Staff Letter (Aug. 10, 2006); Release 2968, *supra* note 172, at n. 45. *See also* Custody Rule FAQs, *supra* note 171.

182 Rule 206(4)-2(a)(5) and (a)(4).

183 A "related person" includes any person, directly or indirectly, controlling or controlled by the adviser, and any person that is under common control.

184 The surprise examination is not required of the adviser if it can demonstrate that the related person acting as qualified custodian is operationally independent. This determination is made by examining the relationship between the adviser and the related person, including whether there are common employees, shared premises, and common supervision. *See* rule 206(4)-2(d)(5).

185 Rule 206(4)-2(a)(6).

186 *See supra* notes 106-108 and accompanying text. Through a series of no-action letters, however, the SEC staff expressed the view that statutorily disqualified persons may act as solicitors if the disqualifying conduct is disclosed in a separate written document to be given to each solicited person (i) at least 48 hours before such solicited person enters into an advisory contract, or (ii) at the time the

c. *Written Agreement.* The solicitation fee must be paid pursuant to a written agreement that:

(i) describes the solicitation activities and the compensation to be paid;

(ii) contains an undertaking by the solicitor to perform his duties according to the agreement and in compliance with the Act; and

(iii) requires the solicitor to provide a prospective client a copy of:

(A) the adviser's disclosure statement (brochure), and

(B) a separate disclosure statement describing the terms of the solicitation arrangement, including that the solicitor is being compensated by the adviser.[187]

Solicitors. The rule defines a solicitor as anyone who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser. The Commission believes that a solicitor would be a "person associated with an adviser" under the Act. The adviser has an obligation to supervise the activities of solicitors.[188]

Client Referrals. Rule 206(4)-3 does not apply to the direction of brokerage in return for client referrals. But the adviser directing brokerage to brokers referring clients to it has a significant conflict of interest. Accordingly, an adviser may be obligated to disclose to clients material information regarding conflicts arising from the arrangement, including any affect on the adviser's ability to obtain best execution.[189]

Pooled Investment Vehicles. The SEC staff has stated that the rule does not apply to payments by an adviser to solicit investments in a pooled investment vehicle sponsored by the adviser.[190]

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solicited person enters into the advisory contract, *if* the solicited person has the right to terminate the advisory contract within five days. Accordingly, the staff no longer issues no-action letters of this type, except if the facts raise novel or unusual circumstances. *See Dougherty & Company LLC*, SEC Staff No-Action Letter (July 3, 2003).

187 If the solicitor is an employee of the adviser, however, the solicitor is not required to provide prospective clients a copy of the adviser's brochure or the separate disclosure statement.

188 For discussion of an adviser's obligation to supervise cash solicitors acting on its behalf, *see Requirements Governing Payments of Cash Referral Fees by Investment Advisers*, Investment Advisers Act Release No. 615 (Feb. 2, 1978) (proposing release); *Requirements Governing Payments of Cash Referral Fees by Investment Advisers*, Investment Advisers Act Release No. 688 (July 12, 1979) (adopting release).

189 *In the Matter of Jamison, Eaton and Wood, Inc., supra* note 138; *In the Matter of Portfolio Advisory Services LLC, supra* note 137; *In the Matter of Founders Asset Management*, Investment Advisers Act Release No. 1953 (July 20, 2001); *In the Matter of Fleet Investment Advisers, Inc. (successor to Shawmut Investment Advisers, Inc.)*, Investment Advisers Act Release No. 1821 (Sept. 9, 1999).

190 *Mayer Brown, LLP*, SEC Staff No-Action Letter (July 15, 2008). In its response, however, the staff noted that the solicitor may itself be an adviser subject to the antifraud provisions of the Act. The staff's response was amended on July 28, 2008 but indicates that the response letter should be deemed

5. *Pay to Play Rule*. On July 1, 2010, the Commission adopted rule 206(4)-5 to address so-called "pay to play" practices in which investment advisers make campaign contributions to elected officials of state or municipal governments in order to influence the award of contracts to manage public pension plan assets and other government investment accounts.[191] The rule applies to SEC-registered investment advisers, certain exempt reporting advisers, and foreign private advisers, who provide investment advisory services, or are seeking to provide investment advisory services, to state and municipal government entities.[192]

   a. *Prohibitions.* The rule contains three main prohibitions:

      (i) *Two-Year Time Out.* An investment adviser is prohibited from receiving compensation for providing advice to a government entity, either directly or through a "covered investment pool", within two years after a contribution by the adviser, or by any of its "covered associates" (which include the adviser's general partner or managing member, executive officers or other individuals with a similar status or function, solicitors, and political action committees they control) to an official of that government entity who can influence the award of advisory business.[193]

      (ii) *Third Party Solicitor Ban.* Neither an investment adviser nor any of its covered associates may provide or agree to provide, directly or indirectly, payment to any third party to solicit government clients for the adviser unless such person is a "regulated person."[194]

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to have been issued on July 15. *See also* rule 206(4)-5 and Section VI. B. 5 of this outline regarding solicitation of government clients.

191 *Political Contributions by Certain Investment Advisers*, Investment Advisers Act Release No. 3043 (July 1, 2010)("Pay to Play Release"), *available at* http://www.sec.gov/rules/final/2010/ia-3043.pdf. For staff responses to frequently asked questions about the rule, visit the SEC's website at http://www.sec.gov/divisions/investment/pay-to-play-faq.htm.

192 Rule 206(4)-5(a).

193 Rule 206(4)-5(a)(1). An adviser subject to the rule is not prohibited from providing advisory services to a government client, even after triggering the two-year time out. Instead, an adviser is prohibited from receiving *compensation* for providing advisory services to such client during the time out. This enables an adviser to act consistently with its fiduciary obligations and provide uncompensated advisory services for a reasonable period of time to allow the government client to replace the adviser. *See also* Section VI. B. 4 regarding the cash solicitation rule that applies to all SEC-registered advisers.

194 Rule 206(4)-5(a)(2)(i). "Regulated persons" include (i) SEC-registered investment advisers that have not, and whose covered associates have not, within two years of soliciting a government entity, made a contribution to an official of that government entity; or bundled any contribution to an official or payment to a political party of a state or locality where the adviser is providing or seeking to provide investment advisory services to a government entity; (ii) registered broker-dealers that are subject to a pay to play rule adopted by the Financial Industry Regulatory Authority that the Commission, by order, finds substantially equivalent or more stringent than rule 206(4)-5; and (iii) a "municipal adviser" registered with the Commission and subject to rules adopted by the Municipal Securities Rulemaking Board that the Commission, by order, finds substantially equivalent or more stringent than rule 206(4)-

(iii) *Bundling Ban.* Rule 206(4)-5 prohibits an adviser and its covered associates from "bundling" others' contributions -- *i.e.* coordinating or soliciting any person or political action committee to make (A) any contribution to an official of a government entity to which the adviser is providing or seeking to provide investment advisory services; or (B) any payment to a political party of a state or locality where the investment adviser is providing or seeking to provide investment advisory services to a government entity.[195]

b. *Catch-All Provision.* Rule 206(4)-5(d) prohibits acts done indirectly, which, if done directly, would violate the rule.

c. *Covered Investment Pools.* Rule 206(4)-5 includes a provision that applies each of the prohibitions of the rule to an adviser that manages assets of a government entity through a "covered investment pool" defined as (i) any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity;[196] or (ii) any company that would be an investment company under section 3(a) of the Investment Company Act but for the exclusions from that definition provided by section 3(c)(1), section 3(c)(7) or section 3(c)(11) of that Act.[197]

d. *Recordkeeping.* Rule 204-2 was amended to require registered advisers that provide investment advisory services to a government entity, or to a covered investment pool in which a government entity is an investor, to make and keep certain records related to the pay to play rule.

6. *Proxy Voting.* A registered adviser that exercises voting authority over client securities is required to vote them in the best interest of the client and not in its own interest. Rule 206(4)-6 requires advisers with voting authority over client securities to:

a. adopt and implement written policies and procedures that are reasonably designed to ensure that the adviser votes in the clients' best interests, and which must specifically address conflicts of interest that may arise between the adviser and its clients;

b. describe their voting policies and procedures to clients, deliver a copy of the policies and procedures to clients upon request, and inform clients how they can obtain information on how the adviser voted their securities; and

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5. This prohibition is limited to third-party solicitors. Thus, the prohibition does not apply to any of the adviser's employees, general partners, managing members, or executive.

195 Rule 206(4)-5(a)(2)(ii).

196 A plan or a program of a government entity includes participant-directed plans, such as college savings plans like 529 plans and retirement plans like 403(b) and 457 plans.

197 Rule 206(4)-5(f)(3).

c. keep certain records relating to voting of client securities.[198]

7. *Supervision.* An adviser has a continuing responsibility to supervise all persons acting on its behalf.[199] The SEC may sanction an adviser that "has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision."[200]

   a. *Supervisor.* Whether a person has responsibility as a "supervisor" depends on whether, under the facts and circumstances of a particular case, the person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.[201]

   b. *Safe Harbor.* Under the Act, a person (*e.g.*, an adviser or an officer of the adviser) will not be deemed to have failed to supervise a person if (i) the adviser had established procedures and a system for applying such procedures that are reasonably expected to prevent and detect the conduct, and (ii) the person reasonably discharged his supervisory duties and had no reasonable cause to believe that the procedures were not being complied with.[202]

8. *Compliance Program.* Under rule 206(4)-7 each registered adviser must establish an internal compliance program that addresses the adviser's performance of its fiduciary and substantive obligations under the Act.

   a. *Chief Compliance Officer.* Each adviser must designate a chief

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198 See also Section VI. A. 5 of this outline.

199 The SEC has stated that the "delicate fiduciary relationship" between an investment adviser and a client imposes an obligation on an adviser to review and to monitor its activities and the activities of its employees. *Shearson Lehman Brothers, Inc. and Stein Roe & Farnham*, Exchange Act Release No. 23640 (Sept. 24, 1986). The Commission has repeatedly emphasized that the duty to supervise is a critical component of the federal regulatory scheme. *See In re Rhumbline Advisers*, Investment Advisers Act Release. No. 1765 (Sept. 29, 1998); *In re Scudder Kemper Investments, Inc.*, Investment Advisers Act Release. No. 1848 (Dec. 22, 1999) (adviser failed reasonably to supervise employee and did not have policies and procedures designed to detect and prevent employees' unauthorized trading in client accounts); *In re Nicholas-Applegate Capital Management*, Investment Advisers Act Release. No. 1741 (Aug. 12, 1998) (adviser failed reasonably to supervise employee and did not have policies and procedures designed to detect and prevent employees from engaging in improper personal trading); *In re Van Kampen American Capital Asset Management, Inc.*, Investment Advisers Act Release. No. 1525 (Sep. 29, 1995) (adviser failed reasonably to supervise employee and did not have policies and procedures designed to detect and prevent employees from mispricing fund securities). Both registered and unregistered advisers have an obligation to supervise persons acting on their behalf. *In the Matter of Wilfred Mickel and Robert A. Littell*, Investment Advisers Act Release No. 2203 (Dec. 15, 2003). *See also In the Matter of Western Asset Management Co. and Legg Mason Fund Adviser, Inc.*, Investment Advisers Act Release No. 1980 (Sept. 28, 2001) (adviser has a duty to supervise a sub-adviser); *TBA Financial Corporation*, SEC Staff No-Action Letter (Nov. 7, 1983) (duty to supervise employees who are also "registered representatives").

200 Section 203(e)(6).

201 *See In re John H. Gutfreund*, 51 S.E.C. 93, 113 (1992).

202 Section 203(e)(6).

compliance officer ("CCO").[203] The CCO must be knowledgeable about the Act and have the authority to develop and enforce appropriate compliance policies and procedures for the adviser. The CCO need not be an employee who does not have other duties.[204]

b. *Policies and Procedures.* Each adviser must also adopt and implement written policies and procedures reasonably designed to prevent the adviser or its personnel from violating the Act.[205] The SEC explained that each adviser, in designing its policies and procedures, should identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks.[206] The SEC has stated that these policies and procedures should cover, at a minimum, the following areas to the extent applicable to the adviser:

(i) Portfolio management processes, including allocation of investment opportunities among clients and consistency of portfolios with clients' investment objectives, disclosures by the adviser, and applicable regulatory restrictions;

(ii) Trading practices, including procedures by which the adviser satisfies its best execution obligation, uses client brokerage to obtain research and other services ("soft dollar arrangements"), and allocates aggregated trades among clients;

(iii) Proprietary trading of the adviser and personal trading activities of supervised persons;

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203 Rule 206(4)-7(c). The Commission has stated that having the title of chief compliance officer does not, in and of itself, carry supervisory responsibilities so that an adviser's chief compliance officer would not necessarily be subject to a sanction for failure to supervise other advisory personnel. Investment Advisers Act Release No. 2204 (Dec. 17, 2003) ("Release 2204") at n. 73 *available at* http://www.sec.gov/rules/final/finalarchive/finalarchive2003.shtml.

204 Release 2204, *supra* note 203 at Section II. C. However, the SEC recently settled an enforcement action alleging that a dually-registered broker-dealer and investment adviser violated section 206(4) of the Advisers Act and rule 206(4)-7 thereunder by failing to adopt and implement compliance policies and procedures specific to its advisory business when its CCO spent about 95% of his time on compliance-related issues for the firm's brokerage business and only about 5% of his time on compliance-related issues for the advisory business. *In the Matter of Feltl & Company, Inc.*, Investment Advisers Act Release No. 3325 (Nov. 28, 2011).

205 Rule 206(4)-7(a). The SEC has brought enforcement actions against advisers for failing to adopt and implement adequate policies and procedures as required by rule 206(4)-7. *See, e.g., In the Matter of OMNI Investment Advisors Inc. and Gary R. Beynon*, Investment Advisers Act Release No. 3323 (Nov. 28, 2011); *In the Matter of The Buckingham Research Group, Inc., Buckingham Capital Management, Inc., and Lloyd R. Karp*, Investment Advisers Act Release No. 3109 (Nov. 17, 2010); *In the Matter of Consulting Services Group, LLC, and Joe D. Meals*, Investment Advisers Act Release No. 2669 (Oct. 4, 2007).

206 The SEC has settled an enforcement action against an adviser that adopted a "pre-packaged" policies and procedures manual that failed to reflect the risk factors or conflicts of interest of the adviser; the SEC found that the adviser violated rule 206(4)-7 by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act by that adviser's supervised persons. *In the Matter of Consulting Services Group, LLC, and Joe D. Meals, supra* note 205.

(iv) The accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements;

(v) Safeguarding of client assets from conversion or inappropriate use by advisory personnel;

(vi) The accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction;

(vii) Marketing advisory services, including the use of solicitors;

(viii) Processes to value client holdings and assess fees based on those valuations;

(ix) Safeguards for the privacy protection of client records and information; and

(x) Business continuity plans.[207]

c. *Annual Review.* The adviser must review the adequacy and effectiveness of its policies at least annually.[208]

9. *Code of Ethics.* All advisers registered with the SEC must adopt and enforce a written code of ethics reflecting the adviser's fiduciary duties to its clients.[209] At a minimum, the adviser's code of ethics must:

a. *Standards of Conduct.* Set forth a minimum standard of conduct for all supervised persons;

b. *Compliance with Federal Securities Laws.* Require supervised persons to comply with federal securities laws;

c. *Personal Securities Transactions.* Require each of an adviser's access persons[210] to report his securities holdings at the time that the person becomes an access person and at least once annually thereafter and to make a report at least once quarterly of all personal securities transactions in reportable securities to the adviser's CCO or other designated person;[211]

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207 Release 2204, *supra* note 203.

208 Rule 206(4)-7(b).

209 Rule 204A-1. *See also, In the Matter of Consulting Services Group, LLC, and Joe D. Meals, supra* note 205 (adviser failed to timely adopt and accurately document ethics code).

210 Rule 204A-1(e)(1) defines "access person." Generally, an access person is a supervised person who has access to non-public information regarding clients' securities purchase or sale of securities.

211 Rule 204A-1(b) (1) (holdings reports), and (2) (transaction reports). Access persons do not have to report holdings of or transactions in: (i) direct obligations in of the U.S. government; (ii) certain bank instruments, commercial paper, and agreements; (iii) shares of money market funds; (iv) shares in open-end investment companies (mutual funds) that are not advised by either the adviser or an entity in a control relationship with the adviser); and (v) shares of a (US) unit investment trust that invests exclusively in an unaffiliated mutual fund. *See* rule 204A-1(j). *See also, M&G Investment*

d. *Pre-approval of Certain Securities Transactions.* Require the CCO or other designated persons to pre-approve investments by the access persons in IPOs or limited offerings;

e. *Reporting Violations.* Require all supervised persons to promptly report any violations of the code to the adviser's CCO or other designated person;

f. *Distribution and Acknowledgment.* Require the adviser to provide each supervised person with a copy of the code, and any amendments, and to obtain a written acknowledgment from each supervised person of his receipt of a copy of the code; and

g. *Recordkeeping.* Require the adviser to keep copies of the code, records of violations of the code and of any actions taken against violators of the code, and copies of each supervised person's acknowledgement of receipt of a copy of the code.

10. *Fraud Against Investors in Pooled Investment Vehicles.* Rule 206(4)-8 prohibits advisers from defrauding investors and prospective investors in pooled investment vehicles they advise.[212] The anti-fraud provisions of the Act (section 206(1) and (2)) prohibit advisers from defrauding "clients." A 2006 court decision created doubt about whether an investor in a pooled investment vehicle (*e.g.*, a hedge fund) advised by an adviser is a "client," and thus whether the SEC could enforce these provisions against an adviser that defrauds the investors, but not the fund.[213]

a. *Prohibition on False or Misleading Statements.* Rule 206(4)-8 prohibits advisers to pooled investment vehicles from making any materially false or misleading statements to investors or prospective investors in those pools.

b. *Prohibition of Other Frauds.* In addition, the rule prohibits advisers to pooled investment vehicles from otherwise defrauding the investors or prospective investors in those pools. This provision is designed to apply more broadly to fraudulent conduct that may not involve statements.

Management Ltd., SEC Staff No-Action Letter (Mar. 1, 2007) (permitting access persons of U.K.-based registered adviser to exclude from reports certain analogous instruments).

212 Rule 206(4)-8. *See Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles,* Investment Advisers Act Release No. 2628 (Aug. 3, 2007), *available at* http://www.sec.gov/rules/final/2007/ia-2628.pdf. *See also, SEC v. Rabinovich & Associates, LP, Alex Rabinovich and Joseph Lovaglio,* 07 Civ. 10547(GEL) (S.D.N.Y.) (Nov. 17, 2008); *SEC v. Moises Pacheco, et al.*, Civil Action No. 09-CV-1355-W-RBB (Nov. 19, 2009) (discussed in *In the Matter of Moises Pacheco,* Investment Advisers Act Release No. 2960 (Dec. 11, 2009)); *SEC v. Thomas J. Petters, et al,* Civil Action No. 09 SC 1750 ADM/JSM (D. Minn.) (Oct. 5, 2010) (discussed in *SEC v. Thomas J. Petters, et al,* Litigation Release No. 21687 (Oct. 18, 2010)); *SEC v. Donald Anthony Walker Young, et al,* Civil Action No. 09-1634 (E.D. Penn.)(Apr. 12, 2011); *SEC. v. Imperium Investment Advisors, LLC, et al,* 8:10-CV-02859-JDW-MAP (M.D.F.L) (June30, 2011) (discussed in *In the Matter of Imperium Investment Advisors, LLC,* Administrative Proceeding File No. 3-14471 (July 20, 2011)).

213 *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).

c. *No Fiduciary Duty.* Rule 206(4)-8 does not create a fiduciary duty to investors or potential investors in a pooled investment vehicle not otherwise imposed by law, nor does it alter any duty or obligation an adviser has under the Advisers Act, or any state law or requirement to investors in a pooled vehicle.[214] In adopting the rule, the SEC explained that rule 206(4)-8 would, however, permit the SEC to enforce an adviser's fiduciary duty created by other law if the adviser fails to fulfill that duty by negligently or deliberately failing to make the required disclosure.

d. *Pooled Investment Vehicles.* Pooled investment vehicles include hedge funds, private equity funds, venture capital funds, and other types of privately offered pools that invest in securities as well as investment companies that are registered with the SEC under the Investment Company Act.[215]

11. *Insider Trading.* Section 204A of the Act requires advisers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information by the adviser or any of its associated persons,[216] including the misuse of material, non-public information about the adviser's securities recommendations and client securities holdings and transactions.[217]

12. *Brochure Rule.*

a. *Firm Brochure.* Rule 204-3, as amended in 2010, requires a registered adviser to prepare and deliver to clients a plain English, narrative brochure that contains all information required by Part 2A of Form ADV, including, among other things, the adviser's business practices, investment strategies, fees, conflicts of interest, and disciplinary information.[218] The adviser must deliver the brochure to a client before or at the time of entering into an advisory contract with the client, and must annually deliver to the client an updated brochure which contains or is accompanied by a summary of material changes, or a summary of

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214 An adviser to a hedge fund may have a separate relationship with an investor in a hedge fund that it advises that gives rise to fiduciary obligations. *U.S. v. Lay,* 566 F. Supp. 2d 652 (N.D. Ohio May 13, 2008).

215 Rule 206(4)-8(b) provides that a "pooled investment vehicle" means any investment company as defined in section 3(a) of the Investment Company Act or any company that would be an investment company under section 3(a) of that Act but for the exclusion provided from that definition by either Section 3(c)(1) or section 3(c)(7) of that Act.

216 The SEC has brought enforcement proceedings against advisers for violating section 204A. *See, e.g., In the Matter of Gabelli & Co. Inc.*, Investment Advisers Act Release No. 1457 (Dec. 8, 1994).

217 *See also, Investment Adviser Code of Ethics*, Investment Advisers Act Release No. 2256 (July 2, 2004), *available at* http://www.sec.gov/rules/final/finalarchive/finalarchive2004.shtml ("We ... remind advisers that they must maintain and enforce policies and procedures to prevent the misuse of material, non-public information, which we believe includes misuse of material, non-public information about the adviser's securities recommendations, and client securities holdings and transaction.").

218 As stated in Section V.B.2, the adviser must also file with the SEC the brochure that it delivered to its client to satisfy its registration requirements under rules 203-1 and 204-1.

material changes with an offer to deliver the updated brochure upon request. [219]

(i) *Non-Required Information.* Delivery of a brochure meeting the requirements of Part 2A does not necessarily satisfy an adviser's full disclosure obligation under the anti-fraud rules.[220] Accordingly, many advisers include additional information in their brochures.

(ii) *Exceptions to Delivery.* Advisers are not required to deliver a brochure to investment company clients or to clients for whom they provide only impersonal services for less than $500.[221]

(iii) *Electronic Delivery.* Advisers may deliver brochures electronically with client consent.[222]

b. *Brochure Supplement.* Rule 204-3 also requires the adviser to deliver a brochure supplement that contains information about an advisory employee, including the employee's educational background, business experience, other business activities, and disciplinary history, to a client before or at the time the employee begins to provide advisory services to that client.[223]

(i) *Covered employees.* An employee must deliver a brochure supplement to clients, if the employee formulates investment advice for the client and has direct client contact; or makes discretionary investment decisions for the client even if the employee has no direct client contact.[224]

(ii) *Exceptions to delivery.* Advisers are not required to deliver a brochure supplement to a client: (i) to whom the adviser is not required to deliver a brochure; (ii) who receives only impersonal service; or (iii) who is an officer, employee or other persons related to the adviser that would be "qualified client" under rule 205-3(d)(1).[225]

(iii) *Electronic Delivery.* Advisers may deliver brochure supplements

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219 Rule 204-3(b)(1) and (2).

220 *See* Part 2 Adopting Release, *supra* note 113, at n. 7.

221 Rule 204-3(c).

222 *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, Investment Advisers Act Release No. 1562 (May 9, 1996) (publishing Commission interpretive guidance with respect to use of electronic media to fulfill investment advisers' disclosure delivery obligations).

223 Rule 204-3(b)(3).

224 *Id.* Note that if the investment advice is provided by a team comprised of more than 5 employees, only the 5 employees that have the most significant responsibility for the day-to-day advice to a client need to provide brochure supplements to that client. For more information, see Part 2 FAQs, *supra* note 113.

225 Rule 204-3(c)(2).

electronically with client consent.

13. *Systemic Risk Reporting on Form PF.* In October 2011, the SEC adopted rule 204(b)-1 requiring registered advisers with at least $150 million in private fund assets under management to submit regular reports on new Form PF. Advisers must file Form PF electronically on a confidential basis. Form PF is designed, among other things, to assist the Financial Stability Oversight Council in its assessment of systemic risk in the U.S. financial system.[226]

    a. *Smaller private fund advisers.* Advisers that manage at least $150 million of private fund assets, but less than the amounts that make them "large private fund advisers," complete only section 1 of Form PF. They file annually within 120 days of the end of their fiscal year.

       Section 1 requires, for each private fund, limited information about the size, leverage, investor types, investor concentration, liquidity and fund performance. This section also requires information regarding strategy, counterparty exposures, and use of trading and clearing mechanisms for each private fund that is a hedge fund.

    b. *Larger Private Funds Advisers.* Three types of "Large Private Fund Advisers" that meet certain thresholds for assets under management based on investment strategy type are required to complete additional sections of Form PF.[227]

       (i) *Large Hedge Fund Advisers.* Advisers managing at least $1.5 billion in hedge fund assets must file quarterly within 60 days of their quarter end and, in addition to Section 1, must complete Section 2 of Form PF.

       Section 2a requires information about aggregate hedge fund assets the adviser manages, such as the value of investments in different types of assets, the duration of fixed income holdings, the value of turnover for certain asset classes and the geographical breakdown of investments. Section 2b requires, for each hedge fund that has net assets of at least $500 million, more granular information about the fund's exposures, leverage, risk profile and liquidity.

       (ii) *Large Private Equity Fund Advisers.* Advisers managing at least $2 billion in private equity fund assets must file annually within 120 days of the end of their fiscal year (same as smaller advisers) and, in addition to Section 1, must complete section 4 of Form PF.

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226 *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF.* Investment Advisers Act Release No. 3308 (Oct. 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3308.pdf ("Form PF Adopting Release"). The staff of the Division of Investment Management has published responses to frequently asked questions on Form PF, *available at* http://www.sec.gov/divisions/investment/pfrd.pfrdfaq.shtml.

227 Form PF Adopting Release, *supra* note 226, at 21.

Section 4 requires information about the extent of leverage incurred by funds' portfolio companies, use of bridge financing, funds' investments in financial institutions, and geographical and industry breakdowns of funds' investments in portfolio companies.

(iii) *Large Liquidity Fund Advisers.* Advisers managing at least $1 billion in combined unregistered and registered money market fund assets must file quarterly within 15 days of their quarter end and, in addition to Section 1, must complete section 3 of Form PF

Item 3 requires information about each liquidity fund's portfolio, certain information relevant to the risk profile of the fund and the extent to which the fund has a policy of complying with all or aspects of rule 2a-7 under the Investment Company Act.

c. *Non-US. Advisers.* A registered adviser with a principal office and place of business outside the U.S. may omit reporting of any private fund that, during the preceding fiscal year: (i) was not organized in the U.S.; (ii) was not beneficially owned by one or more U.S. persons; and (iii) was not offered in the U.S.[228]

14. *Privacy Rules.* Title V of the Gramm-Leach-Bliley Act protects the privacy interests of consumers of financial services, including clients of SEC-registered investment advisers.[229] SEC rules implementing the statute protect only individuals' personal privacy interests, and not those of businesses or individuals who seek to obtain the services of an adviser for business purposes.[230]

a. *Notices.* An adviser must provide clients an *initial* and an *annual* notice of the adviser's privacy policies. The initial notice must be provided no later than when the client enters into an advisory contract.[231]

Content of Notice. Notices must be clear and conspicuous, *i.e.,* reasonably understandable and designed to call attention to the nature and significance of the notice. They must include, among other things: (i) categories of non-public personal information the adviser collects; (ii) categories of information the adviser shares; (iii) categories of

228 General Instruction 1 (last paragraph) to Form PF.

229 Title V is not codified as part of the Advisers Act. It is codified at 15 U.S.C. 6801-6827.

230 *See* rule 248.3(g)(1). The SEC's implementing rules can be found at 17 CFR Part 248 ("Regulation S-P"). The rules apply to SEC-registered advisers. Rule 248.1(b). Advisers that are unregistered or are registered only with the states are subject to privacy regulations overseen by the Consumer Financial Products Board. Regulation S-P was adopted under the Securities Exchange Act, the Investment Company Act, and the Advisers Act; therefore the SEC has the remedies available under those statutes as applicable in enforcing the privacy rules. The SEC staff has posted responses to frequently asked questions about Regulation S-P at www.sec.gov/divisions/investment/guidance/regs2qa.htm.

231 Rules 248.4(a), 248.5(a).

affiliates and non-affiliates with which the adviser shares the information; and (iv) the adviser's policies and practices for protecting the confidentiality and security of information.

Model Form. The SEC has adopted a model form that advisers may choose to use to satisfy the initial and annual notice disclosure requirements. Use of the form provides advisers with a "safe harbor" for the content of the required notice under the privacy rules.[232]

b. *Opt-Out.* An adviser must provide clients with an opportunity to "opt out" or block the adviser from sharing "non-public" personal financial information with nonaffiliated third parties.[233]

Exceptions. An adviser does not have to provide an opt-out right in three circumstances:

(i) the information is provided to an affiliate;[234]

(ii) the adviser shares the information in the course of providing advisory services to the client (*e.g.,* with a broker, transfer agent, or lawyer) with the client's consent, or as required by law;[235] or

(iii) the adviser shares the information with a nonaffiliate that performs services, including marketing, for the adviser, but the adviser must have entered into a contract with the nonaffiliate that prohibits the nonaffiliate from using the information except for the purpose for which it received it.[236]

c. *Safeguarding and Properly Disposing of Client Information.*[237] An

232 17 CFR 248.2, *adopted in, Final Model Privacy Form under the Gramm-Leach-Bliley Act*, Investment Advisers Act Release No. 2950 (Nov. 16, 2009), *available at* http://www.sec.gov/rules/final/2009/34-61003.pdf.

233 Rule 248.10.

234 Subpart B of Regulation S-P governs the use of certain information received by affiliates. This subpart, Regulation S-AM, allows a consumer, in certain limited situations, to block affiliates of advisers from soliciting the consumer, if the solicitation is derived from certain private information that the adviser has shared with an affiliate. Subpart B (Regulation S-AM) differs from Subpart A of Regulation S-P in that it does not restrict the *sharing* of certain information, only the actual *use* of the information to solicit. *See Regulation S-AM: Limitations on Affiliate Marketing*, Investment Advisers Act Release No. 2911 (August, 4, 2009) *available at* http://www.sec.gov/rules/final/2009/34-60423.pdf.

235 Rules 248.14, 248.15.

236 Rule 248.13.

237 The SEC has proposed additional amendments to its privacy rules. In 2012, the SEC proposed rules, including those that could require certain advisers who have custody or client assets or that otherwise qualify as financial institutions to (i) develop a program to identify "red flags" associated with identity theft, and (ii) have policies and procedure designed to prevent and mitigate identity theft in connection with its consumer accounts. *Identity Theft Red Flags Rules*, Investment Company Act Release No. 29969 (Feb. 28, 2012) *available at* http://www.sec.gov/rules/proposed/2012/ic-29969.pdf. In 2008, the SEC proposed amendments to its rules, including (i) a requirement that individuals be notified under certain circumstances in the event of a breach of security, (ii) additional guidance as to information that must be included in the safeguard and disposal polices, and (iii) a limited exception to the notice and opt-out requirements to allow a departing registered representative to take certain client

adviser must adopt written procedures reasonably designed to protect client records and information and to dispose of consumer report information properly.[238]

d. *"Non-public personal information"* includes "personally identifiable financial information" (a defined term) and any list, description, or other grouping of clients derived using "personally identifiable financial information" (*e.g.*, a client list):[239]

(i) "Personally identifiable financial information" includes information a client provides an adviser, information that results from services the adviser provides to the client, and information an adviser otherwise obtains about the client in connection with providing advisory services.[240]

(ii) "Non-public personal information" does not include "publicly available information"— *i.e.*, information the adviser reasonably believes is lawfully made available to the general public from government records, widely distributed media, or disclosures to the general public required by law.[241]

15. *Form 13F Disclosure*. An SEC-registered investment adviser that exercises investment discretion over at least $100 million in "section 13(f) securities" must periodically file Form 13F with the SEC.[242] This requirement was designed "to create a central depository of historical and current data about the investment activities of institutional investment managers" to assist investors and regulators.[243]

"Section 13(f) securities" generally include equity securities that trade on an exchange (including the NASDAQ National Market System).[244] Form 13F must be filed electronically, via the SEC's Electronic Data Gathering,

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information when leaving a firm. *Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Personal Information,* Investment Advisers Act Release No. 2712 (Mar. 4, 2008).

238 Rule 248.30(a); 248.30(b). The SEC has settled an enforcement action against an investment adviser that failed to adopt procedures reasonably designed to protect client records and information. *See In the Matter of LPL Financial Corporation*, Investment Advisers Act Release No. 2775 (Sept. 11, 2008).

239 Rule 248.3(t)(1).

240 Rule 248.3(u)(1).

241 Rule 248.3(t)(2).

242 Section 13(f) of the Exchange Act; rule 13f-1(a) under the Exchange Act. *See In the Matter of Quattro Global Capital, LLC.*, Investment Advisers Act Release No. 2634 (Aug. 15, 2007) (adviser failed to File Form 13F); *In the Matter of Cabot Money Management Inc.*, Investment Advisers Act Release No. 1577 (Aug. 15, 1996).

243 S. Rep. No. 94-75, 94th Cong., 2d Sess. 82-85 (1975). Each quarter, the SEC publishes a list of section 13(f) securities to assist institutional investment managers in the preparation of their Form 13F filings, *available at* http://www.sec.gov/divisions/investment/13flists.htm.

244 "Section 13(f) securities" also include certain equity options and warrants, shares of closed-end investment companies, and some convertible securities. Shares of open-end investment companies are not "section 13(f) securities." Rule 13f-1(c). The SEC publishes an official list of section 13(f) securities, *available at* http://www.sec.gov/divisions/investment/13flists.htm.

Analysis and Retrieval ("EDGAR") system, within 45 days after the end of the March, June, September, and December calendar quarters. Form 13F reports must identify, among other things: (i) the name of the issuer; (ii) the number of shares owned; and (iii) the fair market value, as of the end of the quarterly filing period, of the reported securities.[245]

Non-U.S. Advisers. Non-US investment advisers must file Form 13F if they (i) use any means or instrumentality of United States interstate commerce in the course of their business; and (ii) exercise investment discretion over $100 million or more in section 13(f) securities.[246]

16. *Large Trader Reporting.* An investment adviser that qualifies as a "large trader" must obtain a large trader identification number from the SEC, file and periodically update Form 13H, and disclose to each SEC-registered broker-dealer through which it trades its large trader identification number and all accounts to which that number applies.[247] These requirements were designed to assist the SEC in both identifying, and obtaining trading information on, market participants that conduct a substantial amount of trading activity.[248]

An adviser is a "large trader" if it exercises investment discretion over one or more accounts through which transactions in "national market system securities" are effected through one or more registered broker-dealers in amounts that, in the aggregate, amount to either: (i) 2 million shares or shares with a fair market value of $20 million during a calendar day; or (ii) 20 million shares or shares with a fair market value of $200 million during a calendar month.[249]

National market system securities. These securities include listed options and equity securities listed on an exchange (including the NASDAQ National Market System).[250] The scope of securities that fall under this definition is narrower than the scope of securities that trigger Form 13F filing.[251]

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245 The Division of Investment Management has published a "FAQ" regarding Form 13F ("13F FAQs"), *available at* http://www.sec.gov/divisions/investment/13ffaq.htm.

246 *See also* 13F FAQs *at* FAQ #4.

247 *See Large Trader Reporting*, Exchange Act Release No. 34-64976 (July 27, 2011) ("LTR Release"). The Commission adopted rule 13h-1 and related Form 13H, as directed by section 13(h) of the Exchange Act, on July 27, 2011. The rule also requires registered broker-dealers to monitor accounts for the purpose of identifying "unidentified large traders," capture certain information relating to all transactions on behalf of large traders and unidentified large traders that are effected directly or indirectly by or through them, and make such information available to the Commission through the already-established trade-reporting infrastructure, commonly referred to as the "electronic blue sheets." *See id.*

248 *Id.*

249 *See id.*

250 *See* Regulation NMS, rule 600(b)(46), (47) and (82).

251 *See supra* note 244 and accompanying text.

To comply, a large trader must file a Form 13H initial filing (via EDGAR) generally within 10 days after effecting aggregate transactions equal to or greater than the identifying activity level.[252] A large trader must then submit an annual filing within 45 days after the end of each calendar year, and must file an amendment no later than the end of the calendar quarter in which information became stale.[253]

Non-U.S. Advisers. Non-U.S. investment advisers that are "large traders under the rule" (*i.e.*, trade through SEC-registered broker-dealers) must comply with the rule's filing and disclosure requirements.[254]

C. Contractual Requirements

The Act does not require advisory contracts to be written[255] and the existence of a contract and the interpretation of its terms is generally a matter for state law. Section 205 of the Act, however, requires all advisory contracts to include certain provisions and prohibits the contracts from including other provisions entered into by advisers registered with, or required to be registered with, the SEC.

1. *Advisory Fees.* Advisers and clients are free to mutually agree to the amount of the adviser's compensation for its services, and the method by which it will be paid.[256]

   Performance Fees. With significant exceptions discussed below, section 205(a)(1) of the Act prohibits advisers from entering into a contract with a client that varies with the adviser's success in managing the client's money, *i.e.,* a fee based on a share of the capital gains or appreciation of a client's

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252 The form requires disclosure of, among other things, the large trader's contact information, its and its affiliates companies businesses, the forms it and its securities affiliates file with the Commission, its organizational structure and legal form, and a list of broker-dealers with which it maintains accounts. *See id.*

253 *See* LTR Release. A large trader may avoid updating filings if it obtains "inactive status" through a Form 13H filing by not having effected aggregated transactions in excess of the thresholds at any time during the previous full calendar year. *See id.*

254 Where the laws of a foreign jurisdiction prevent a non-U.S. large trader (whether itself a broker-dealer or adviser) from disclosing certain personal identifying information of an underlying principal, foreign large traders or representatives of foreign large traders may request an exemption from the SEC pursuant to section 36 of the Exchange Act and subsection (g) of rule 13h-1. *See id.*

255 However, section 15(a) of the Investment Company Act requires advisory contracts with investment companies to be in writing.

256 The SEC staff has taken the position that an investment adviser that charges fees which substantially exceed those charged by other investment advisers may violate section 206 of the Act, unless it discloses to existing and prospective clients that such a fee is higher than that charged by other advisers that provide the same or similar services. The staff had indicated that it will consider an advisory fee greater than 2% of the total assets under management as excessive and would violate section 206 unless the adviser disclosure is made that the fee is higher than that normally charged in the industry. *See Equitable Communications Co.*, SEC Staff No-Action Letter (Feb. 26, 1975); *Consultant Publications, Inc.*, SEC Staff No-Action Letter (Jan. 29, 1975); *Financial Counseling Corporation*, SEC Staff No-Action Letter (Dec. 7, 1974); *John G. Kinnard & Co.,* Inc., SEC Staff No-Action Letter (Nov. 30, 1973).

funds.[257] Congress included this provision in the Act because of its concern that a performance fee would encourage undue speculation with clients' investments.

a. *Assets Under Management.* The commonly charged fee based on an amount of assets under management is specifically excepted.[258]

b. *Fulcrum Fee.* The Act excepts from the performance fee prohibition a type of fee known as a "fulcrum fee." This is a fee for "big players" where the investment advisory contract involves registered investment companies or clients with over $1 million of assets.[259] The fee must be based on the asset value of the funds under management over a "specified period" and must increase or decrease proportionately with the "investment performance" of funds under management in relation to an "appropriate index of securities prices."[260]

c. *Non-U.S. Clients.* The Act also excepts contracts with persons who are not residents of the United States.[261] Congress added this exception in 1996 in recognition that the common use of performance fee arrangements in other countries placed U.S. advisers at a competitive disadvantage.

d. *Qualified Clients.* Rule 205-3 permits an adviser to enter into a performance fee contract with certain "qualified clients." A qualified client is a:

    (i) natural person or company that has at least $1,000,000 under management with the adviser immediately after entering into the

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257 Section 205(a)(1). The SEC staff has taken the position that section 205(a)(1)'s prohibition of investment advisory contracts that contain performance fees extends to investment advisory contracts that provide for "contingent fees." *Contingent Advisory Compensation Arrangements*, Investment Advisers Act Release No. 721 (May 16, 1980). A contingent fee is "an advisory fee [that] will be waived or refunded, in whole or in part, if a client's account does not meet a specified level of performance" or that is contingent on the investment performance of the funds of advisory clients.

258 Section 205(b)(1).

259 Section 205(b)(2). The SEC has published a release discussing factors that investment companies considering entering into a fulcrum fee should consider. Investment Advisers Act Release No. 113 (Apr. 18, 1972).

260 Rules 205-1 and 205-2 define the terms in the text. *But see Royce Value Trust*, SEC Staff No-Action Letter (Dec. 22, 1986) (the SEC staff stated it would not object if an advisory agreement contained a performance fee that decreased at a greater rate than it increased and provided for no compensation if the net asset value per share declined). The SEC has instituted several enforcement cases against advisers who entered into advisory contracts with investment companies that charge performance fees that did not comply with section 205(b). In each case, the adviser charged the fund more that it could charge under section 205(b). *In the Matter of Gartmore Mutual Fund Capital Trust*, Investment Advisers Act Release No. 2548 (Sept. 7, 2006); *In the Matter of Putnam Investment Management*, LLC, Investment Advisers Act Release No. 2547 (Sept. 7, 2006); *In the Matter of Numeric Investors LLC*, Investment Advisers Act Release No. 2546. (Sept. 7, 2006); *In the Matter of Kensington Investment Group, Inc.*, Investment Advisers Act Release No. 2545 (Sept. 7, 2006).

261 Section 205(b)(5).

contract;[262]

(ii) natural person or company that the adviser reasonably believes has a net worth of more than $2 million at the time the contract is entered into,[263] or is a "qualified purchaser";[264] or

(iii) natural person who is an officer, director, trustee, or general partner (or a person serving in a similar capacity) of the adviser, or an employee who participates in investment decisions of the adviser and has done so for at least 12 months.[265]

e. *Qualified Purchaser Funds.* The Act also excepts contracts with certain funds not registered under the Investment Company Act because they are offered only to certain wealthy or sophisticated investors.[266] The funds, which include many hedge funds, rely on the exception from the definition of "investment company" provided by section 3(c)(7) of the Investment Company Act.

f. *Other Funds.* Rule 205-3 excepts contracts with other types of funds, but only if *each* equity owner of the company is a qualified client with whom the adviser could otherwise enter into a performance fee contract under the rule.[267] This exception is available to (i) public investment companies registered under the Investment Company Act of 1940, (ii) business development companies, and (iii) private investment companies that rely on the exception provided by section

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262 Section 418 of Dodd-Frank Act directed the SEC to periodically adjust for inflation the dollar amount threshold for a "qualified client" every five years. In 2011, SEC issued an order to increase the minimum amount of assets under management threshold from $750,000 to $1,000,000. *See Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 under the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3236 (July 12, 2011) (the "Performance Fee Order"). The SEC then amended rule 205-3 to codify the order in the rule. *See Investment Adviser Performance Compensation*, Investment Advisers Act Release No. 3372 (Feb. 15, 2012) ("Release 3372").

263 The Performance Fee Order increased the dollar amount for the threshold from $1.5 million to $2 million. The SEC then amended rule 205-3 to codify the order in the rule and to exclude the value of a person's primary residence and certain property-related debts from the test of whether a person has sufficient net worth to be considered a "qualified client." *See* Release 3372, *supra* note 262.

264 A "qualified purchaser" is defined in the rule by reference to section 2(a)(51) of the Investment Company Act, which generally defines a "qualified purchaser" to include: (i) a natural person who owns not less than $5,000,000 in investments; (ii) a trust that meets certain requirements; and (iii) any person (including an investment adviser) who in the aggregate owns and invests on a discretionary basis not less than $25,000,000 in investments.

265 Rule 205-3(d)(1)(iii).

266 Section 205(b)(4).

267 For a discussion of some of the contours of this exception, *see Seligman New Technologies Fund II, Inc.*, SEC Staff No-Action Letter (Feb. 7, 2002). The adviser itself and any equity owner not charged a performance fee need not be qualified clients. Rule 205-3(b). In an arrangement involving multiple tiers of funds, the analysis of whether a performance fee may be charged must be repeated at each tier. *Exception to Allow Registered Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account*, Investment Advisers Act Release No. 1731 (July 15, 1998).

3(c)(1) of the Investment Company Act.[268]

Non-U.S. Funds. The SEC staff has stated that if the fund is organized under the laws of a non-U.S. country, only the equity owners that are U.S. residents must be qualified clients.[269]

2. *Assignments of Advisory Contracts.* Advisory contracts must contain a provision prohibiting their assignment without consent of the client.[270] An assignment generally includes any direct or indirect transfer of an advisory contract by an adviser or any transfer of a controlling block of an adviser's outstanding voting securities.[271] A transaction that does not result in a change of actual control or management of the adviser (*e.g.*, a corporate reorganization) would not be deemed to be an assignment for these purposes.[272]

3. *Notification of Partnership Changes.* If the adviser is organized as a partnership, each of its advisory contracts must provide that the adviser will notify the client of a change in its membership.[273]

4. *Hedge Clauses.* The Act voids any provision of a contract that purports to waive compliance with any provision of the Act.[274] The SEC staff takes the position that an adviser that includes any such provision in a contract misleads its clients in violation of the Act's anti-fraud provisions by creating in the mind of the client the belief that a legal right or remedy under the Act is not available.[275]

   Indemnification Clauses. Historically, the SEC staff has taken the position that prohibition would, for example, preclude an adviser from purporting to limit its culpability to acts involving gross negligence or willful malfeasances,[276] even if the hedge clause explicitly provides that rights

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268 Rule 205-3(b) and (d)(3).

269 *See Lazard Frères Asset Management*, SEC Staff No-Action Letter (Feb. 12, 1996).

270 Section 205(a)(2).

271 Section 202(a)(1).

272 Rule 202(a)(1)-1. While rule 202(a)(1)-1 was adopted primarily to deal with intra-corporate reorganizations and reorganizations resulting from changes in domicile, the Division of Investment Management explained in a staff no-action letter that the rule is not so limited. *Zurich Insurance Company, Scudder Kemper Investments*, SEC Staff No-Action Letter (Aug. 31, 1998). Zurich involved a complex corporate transaction, the substance of which the Division did not address. Instead, the Division stated that the adviser must itself evaluate whether a particular transaction involves a change of actual control or management.

273 Section 205(a)(3).

274 Section 215(a).

275 *Opinion of the General Counse*l, Investment Advisers Act Release No. 58 (Apr. 10, 1951). The SEC has instituted enforcement actions against advisers that have utilized hedge clauses in their advisory contracts. *In the Matter of William Lee Parks*, Investment Advisers Act Release No. 736 (Oct. 27, 1980); *In the Matter of Olympian Financial Services*, Inc. Investment Advisers Act Release No. 659 (Jan 16. 1979).

276 *Auchincloss & Lawrence Inc.*, SEC Staff No-Action Letter (Feb. 8, 1974).

under federal or state law cannot be relinquished.[277] More recently, the SEC staff has stated that whether such an indemnification clause would violate the Act's anti-fraud provisions, turns on "the form and content of the particular hedge clause (*e.g.*, its accuracy), any oral or written communications between the investment adviser and the client about the hedge clause, and the particular circumstances of the client."[278]

5. *Termination Penalties.* The SEC staff takes the position that certain fees that may have the effect of penalizing a client for ending the advisory relationship, or that may make the client reluctant to terminate an adviser, may be inconsistent with the adviser's fiduciary duties and may violate section 206.[279] Thus, the SEC staff interprets the anti-fraud provisions of the Act to require an adviser receiving its fee in advance to give a client terminating a contract a *pro rata* refund of pre-paid fees (less reasonable expenses),[280] unless the adviser is to receive a pre-determined amount upon termination for services already performed, and the client is provided adequate disclosure.[281]

D. <u>Recordkeeping Requirements</u>

The SEC generally requires a registered adviser to maintain two types of books and records: (i) typical accounting and other records that any business would normally keep; and (ii) certain additional records the SEC believes necessary in light of the adviser's fiduciary duties.[282]

The requirement to keep records does not turn on the medium in which a document is created or maintained. Thus, electronic documents, including e-mails, must be maintained if they meet the required record described below.

1. *Typical Records*

   a. All checkbooks, bank statements, and reconciliations.

   b. All written agreements entered into by the adviser with any client or otherwise relating to the business of the adviser, *e.g.,* rental and service agreements, mortgages, employment contracts, advisory contracts.

   c. All invoices or statements relating to the adviser's business.

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277 *Omni Management Corp.* SEC Staff No-Action Letter (Dec. 13, 1975); *First National Bank of Akron*, SEC Staff No-Action Letter (Feb. 27. 1976).

278 *Heitman Capital Management, LLC, et al.*, SEC Staff No-Action Letter (Feb. 12. 2007).

279 *See, e.g., National Deferred Compensation*, SEC Staff No-Action Letter (Aug. 31, 1987) ("an adviser may not fulfill its fiduciary obligations if it imposes a fee structure penalizing a client for deciding to terminate the adviser's service or if it imposes an additional fee on a client for choosing to change his investment").

280 *National Regulatory Services*, SEC Staff No-Action Letter (Dec. 2, 1992). The staff does not see this view altered by the decision *Transamerica v. Lewis*, 444 U.S. 11 (1979), that clients do not have a private right of action under section 206 of the Act, because they continue to have rights to sue for equitable damages under section 215 of the Act.

281 *BISYS Fund Services, Inc.,* SEC Staff No-Action Letter (Sept. 2, 1999).

282 Rule 204-2.

d. All cash receipts and disbursement journals, other journals, appropriate ledger accounts, all trial balances, financial statements, and internal audit working papers relating to the business of the adviser.

2. *Additional Records*

a. A record of the personal securities transactions of the adviser and its employees.

b. Copies of each report of personal securities holdings made by an access person under the adviser's code of ethics.

c. Documents supporting an adviser's decision to approve an access person's personal securities transactions.

d. A list of all persons who currently are "access persons" and who have been access persons within the last five years.

e. A memorandum of each order given by the adviser for the purchase or sale of any security and any instruction from the client concerning such purchase and sale.

f. A cross reference of securities held by client and by issuer.

g. All written communications received and copies of all written communications sent by the adviser relating to:

(i) any recommendation made or proposed to be made, and any advice given or proposed to be given;

(ii) any receipt, disbursement or delivery of funds or securities; or

(iii) the placing or executing of any order to purchase or sell any security.

h. Copies of all circulars, advertisements, newspaper articles, etc., sent to 10 or more persons.

i. A list of all accounts over which the adviser has discretionary authority.

j. Copies of any power of attorney.

k. A copy of each written statement given to any client in compliance with the brochure rule and any document prepared in compliance with the requirements of Form ADV.

l. Clients' acknowledgement of receipt of a solicitation agreement.

m. Documents substantiating any performance advertised.[283]

283 Rule 204-2(a)(16). *See* Investment Advisers Act Release No. 1135 (Aug. 17, 1988) (adopting paragraph (a)(16)); *see also Salomon Brothers Asset Management Inc. and Salomon Brothers Asset Management Asia Pacific Limited*, SEC Staff No-Action Letter (July 23, 1999) (explaining that records needed to be retained to substantiate performance). In addition, rule 204-2(e)(3)(ii) provides that advisers that had relied on the exemption from registration under section 203(b)(3) of the Act before

n. Certain additional records if the adviser has custody or possession of clients' cash or securities.[284]

o. Copies of the code of ethics and amendments thereto.

p. Records of violations of the code by supervised persons and of any actions taken against violators of the code of ethics.

q. Copies of each supervised person's written acknowledgment of receipt of a copy of the code of ethics.

r. Certain additional records regarding political contributions and advisory services to any government entity.[285]

3. *Other Requirements Regarding Recordkeeping*

a. All books and records required to be kept by the rule must be maintained and preserved in any easily accessible place for a period of no less than five years.[286]

b. Records required to be kept may be kept in micrographic media (*e.g.*, microfilm or microfiche) or in electronic storage media (*e.g.*, optical storage discs, CD ROMs).[287]

c. There are special recordkeeping rules for non-resident investment advisers.[288]

E. Applicability to Non-U.S. Advisers.

The SEC has stated that most of the requirements (discussed above) do not apply with respect to the non-U.S. clients of an SEC registered adviser whose principal place of business is not in the U.S.[289] For example, a non-U.S. adviser is not

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July 21, 2011 (the private adviser exemption) will not be subject to the requirement of maintaining records to support their calculation of the performance, or rate of return, of the accounts they managed or securities they recommended for any period prior to their registration with the SEC, provided that they continue to preserve any records in their possession that pertain to such performance or rate of return.

284 Rule 204-2(a)(17)(iii) and (b).

285 Rule 204-2(a)(18) and (h).

286 Rule 204-2(e). The first two years, the records must be kept in the offices of the adviser.

287 Rule 204-2(g). An adviser storing records in electronic storage media must establish and maintain procedures: (i) to preserve the records and safeguard them from loss, alteration or destruction; (ii) limit access to authorized personnel; and (iii) reasonably assure that any reproduction of paper records onto electronic media is accurate. *See In the Matter of Anthony Fields, CPA, et al.*, Investment Advisers Act Release No. 3348 (Jan. 4, 2012) (The SEC has instituted administrative proceedings alleging that adviser violated section 204 of the Advisers Act and rules 204-2(a)(11) and 204-2(e)(3)(i) thereunder by utilizing several email and online communication providers, each of which routinely deletes emails and online communications after six months, and doing nothing to retain these communications).

288 Rule 204-2(j).

289 *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Investment Advisers Act Release No. 2266 (July 20, 2004) at §II.C.(3)(c)(this rule was vacated by a federal court in 2006, *see supra* note 213). *See also* section 203(b)(3) of the Advisers Act amended by the Dodd-Frank Act,

required to maintain non-U.S. person client assets in accordance with the custody rule.

The SEC staff has stated that a non-U.S. adviser registered with the SEC is subject to examination by SEC staff and must maintain certain records with respect to all of its clients, including non-U.S. clients.[290]

F. Administrative Oversight

All records of a registered adviser (and not only those required to be created or maintained pursuant to SEC rule) are subject to examination by SEC staff.[291] Personnel in the SEC's Office of Compliance Inspections and Examinations located at SEC headquarters and various regional offices usually conduct inspections. All examinations are confidential.[292]

1. *Types of Inspections.* There are generally three types of inspections.

   a. *Examinations of High-Risk Investment Advisers.* The SEC staff utilizes a risk-based process, identifying higher-risk investment advisers for examination consideration and focusing examination resources on certain higher-risk activities at selected investment advisers, including conflicts of interest, portfolio management, valuation, performance, advertising and asset verification. Typically, higher-risk investment advisers are identified based on (i) information contained in regulatory filings; (ii) assessments made during past examinations; and/or (iii) other criteria and available information.[293]

Release 3222, *supra* note 68 and Section III. B. 3 of this outline for discussion regarding foreign private adviser exemption.

290 The SEC staff has provided guidance in a series of no-action letters regarding the recordkeeping obligations of registered advisers that are located offshore. Under that analysis, the registered adviser must, in order to rely on the no-action relief, comply with the Act's recordkeeping rules, other than (i) rules 204-2(a)(3) and (7) with respect to transactions involving offshore clients that do not relate to advisory services performed by the registered adviser on behalf of United States clients or related securities transactions; and (ii) rules 204-2(a)(8), (9), (10), (11), (14), (15) and (16) and 204-2(b) with respect to transactions involving, or representations or disclosures made to, offshore clients. *See, e.g., Royal Bank of Canada*, SEC Staff No-Action Letter, (June 3, 1998). The Dodd-Frank Act added section 214(b) to the Advisers Act, which provides extraterritorial jurisdiction to U.S. federal courts regarding actions or proceedings brought by the Commission or the United States for violation of section 206 of the Act involving (i) conduct within the United States even if the violation is committed by a foreign adviser and involves only foreign investors; or (ii) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

291 *See* section 204 ("All records (as so defined) of such investment advisers are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations." (emphasis added)).

292 Section 210(b) of the Act generally prohibits the SEC or the SEC staff from disclosing publicly either the existence of an examination or investigation conducted under the Act, or the results of or any facts ascertained during an examination or investigation.

293 *See Study on Enhancing Investment Adviser Examinations* (Jan. 19, 2011), *available at* http://sec.gov/news/studies/2011/914studyfinal.pdf (staff study required by section 914 of the Dodd-Frank Act, which directed the Commission to review and analyze the need for enhanced examination and enforcement resources for investment advisers); Commissioner Elisse B. Walter, *Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IV of the Dodd-*

b. *Special Purpose Reviews*. The SEC staff conducts risk-targeted examination sweeps regarding specific areas of concern within the financial services industry covering a broad sample of regulated entities regarding those areas. These sweeps are typically limited in scope. In addition, the SEC staff conducts limited scope examinations of an investment adviser's general business activities and a targeted set of the adviser's books and records to help OCIE better assess the risk profile of an investment adviser.[294]

c. *Cause Examinations.* These may be based on receipt of a complaint from a client or a competitor, press reports of problems, rumors, or anonymous tips.

In addition, OCIE launched a presence exams initiative in 2012 to conduct focused, risk-based examinations of investment advisers to private funds that registered with the Commission following the repeal of the private adviser exemption.[295] The presence exams include three phases: (i) an initial phase of industry outreach and education; (ii) followed by a coordinated series of examinations of a significant percentage of newly registered advisers focusing on the highest risk areas of their businesses; and (iii) culminating in the publication of a series of "after action" reports, reporting to the industry on the broad issues, risks and themes identified during the course of the examinations.[296]

2. *Focus of Inspections.* Examiners will generally focus on the various activities at an investment adviser deemed by the staff to be high risk. Among other things, the staff is seeking to detect violations of the federal securities laws, including the requirement that the adviser have effective compliance policies and procedures. When the SEC adopts new rules that are applicable to investment advisers, examiners may inquire about the areas affected by such rules and review relevant documentation to assess how the adviser is complying with the new requirements. Other examination focus areas are determined by the purpose for conducting the exam, business activities of the investment adviser, and the compliance controls surrounding those activities.[297]

3. *Results of Inspection.* Generally, there are three possible results from an examination.

   a. The SEC staff finds no problems and sends the adviser a letter stating that the inspection is finished (a rare event!).

Frank Wall Street Reform and Consumer Protection Act) (Jan. 19, 2011), *available at* http://sec.gov/news/speech/2011/spch011911ebw.pdf.

294 *Id.*

295 *See Letter to Newly Registered Investment Advisers from Drew Bowden, Deputy Director, Office of Compliance Inspections and Examinations, SEC* (Oct. 9, 2012), *available at* http://www.sec.gov/about/offices/ocie/letter-presence-exams.pdf.

296 *See* Norm Champ, "*What SEC Registration Means for Hedge Fund Advisers*" (May 11, 2012), *available at* http://sec.gov/news/speech/2012/spch051112nc.htm.

297 *See Study on Enhancing Investment Adviser Examinations, supra note* 293.

b. The SEC staff sends an "exam summary letter," which informs the adviser of any violations or possible violations found and requests the adviser promptly to take any necessary corrective steps and submit a written response to the SEC staff of the corrective actions taken.

c. The SEC staff refers the inspection to the SEC's Division of Enforcement for further consideration and possible commencement of an enforcement proceeding—not common as a first step.

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3270. Outside Business Activities of Registered Persons

No registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member. Passive investments and activities subject to the requirements of NASD Rule 3040 shall be exempted from this requirement.

• • • **Supplementary Material: --------------**

.01 Obligations of Member Receiving Notice. Upon receipt of a written notice under Rule 3270, a member shall consider whether the proposed activity will: (1) interfere with or otherwise compromise the registered person's responsibilities to the member and/or the member's customers or (2) be viewed by customers or the public as part of the member's business based upon, among other factors, the nature of the proposed activity and the manner in which it will be offered. Based on the member's review of such factors, the member must evaluate the advisability of imposing specific conditions or limitations on a registered person's outside business activity, including where circumstances warrant, prohibiting the activity. A member also must evaluate the proposed activity to determine whether the activity properly is characterized as an outside business activity or whether it should be treated as an outside securities activity subject to the requirements of NASD Rule 3040. A member must keep a record of its compliance with these obligations with respect to each written notice received and must preserve this record for the period of time and accessibility specified in SEA Rule 17a-4(e)(1).

Amended by SR-FINRA-2009-042 eff. Dec. 15, 2010.
Adopted by SR-NASD-88-34 eff. Oct. 13, 1988.

Selected Notices: 88-5, 88-45, 88-86, 89-39, 90-37, 94-44, 94-93, 96-33, 01-79, 10-49.

Print

94-44 Board Approves Clarification On Applicability Of Article III, Section 40 Of Rules Of Fair Practice To Investment Advisory Activities Of Registered Representatives

SUGGESTED ROUTING
Senior Management Internal Audit Legal & Compliance Registration Training

Executive Summary

The Board of Governors, acting on the recommendation of a special Ad Hoc Committee, is clarifying the applicability of Article III, Section 40 of the NASD Rules of Fair Practice to the investment advisory activities of registered representatives. This Notice describes those investment advisory activities that constitute private securities transactions within the scope of Article III, Section 40.

Summary Of Article III, Section 40

Article III, Section 40 provides that any person associated with a member who participates in a private securities transaction must, prior to participating in the transaction, provide written notice to the member with which he or she is associated. The required notice must describe the transaction, the associated person's role, and state whether the associated person has received or may receive selling compensation. The member must respond to the notice in writing indicating whether it approves or disapproves the proposed transaction. Where the registered person has received or may receive selling compensation, the member approving the transaction must record the transaction in its books and records and must supervise the registered person's participation in the transaction as if it was the member's own under Article III, Section 27 of the Rules of Fair Practice.

Section 40 defines "private securities transaction" as any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the U.S. Securities and Exchange Commission (SEC).

"Selling compensation" is defined as any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's fees; securities or rights to acquire securities; rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements.

Notice to Members 85-84, which announced the approval of Article III, Section 40, broadly defined the scope of selling compensation and deliberately meant to include the receipt of any item of value received or to be received, directly or indirectly, from the execution of any such securities transaction. The Notice also discussed that Article III, Section 40 was specifically designed to apply to situations where the registered person was acting as a salesperson or in some other capacity.

Background Of The Application Of Section 40 To RR/RIAs

The National Business Conduct Committee (NBCC), at its May 1991 meeting, considered the issue of the applicability of Article III, Section 40 of the Rules of Fair Practice to certain activities of individuals who are registered both as representatives of an NASD member firm and with the SEC as a Registered Investment Adviser ("dually registered person" or "RR/RIA"), and who conduct their investment advisory activities "away from" their NASD member employer. The issue was considered by the NBCC as a result of a number of requests for interpretations relating to programs under which registered representatives directed securities transactions for their investment advisory clients to a broker/dealer other than the firm with which they are registered.

The NBCC concluded that Article III, Section 40, consistent with the policy announced when the section was adopted, applied in such a manner as to cover certain activities of individuals who are registered both as a representative of an NASD member and with the SEC as an investment adviser. The NBCC stated that Section 40 should apply to all investment advisory activities conducted by these dually registered persons that result in the purchase or sale of securities by the associated person's advisory clients, with the exception of their activities on behalf of the member. The NBCC also determined that the receipt of compensation as a result of investment advisory activities constituted the receipt of selling compensation as defined in Section 40.

The NBCC then issued *Notice to Members 91-32,* explaining its position and soliciting comments on other advisory compensation arrangements, including "wrap" fees, that had not been before the Committee. In response to *Notice to Members 91-32,* the NASD received over 150 comment letters. Few of the letters addressed the NBCC's request for information on other compensation arrangements but rather sought to clarify the NBCC's view on the application of Section 40 to various factual scenarios involving the activities of dually registered persons. After reviewing the comments, the NBCC and the Board appointed an Ad Hoc Committee of the Board to examine this entire area. This special committee met numerous times to review the comment letters, the history and intent of Section 40, and to receive input from various segments of the securities industry, including those most affected by the NBCC's position.

Following extensive discussions and deliberations, the Ad Hoc Committee formulated a clarification which the Board considered and adopted. The following discussion explains the Board's clarification of its position on the scope of transactions that would be deemed to be "for compensation" under Article III, Section 40 with respect to registered representatives/registered investment advisers.

Clarification

In clarifying its previous position in *Notice to Members 91-32,* the Board focused primarily upon the RR/ RIA's participation in the execution of the transaction—meaning participation that goes beyond a mere recommendation. Article III, Section 40, therefore, applies to any transaction in which the dually registered person participated in the execution of the trade.

An example of a RR/RIA clearly participating in the execution of trades is where he or she enters an order on behalf of the customer for particular securities transactions either with a brokerage firm other than the member they are registered with, directly with a mutual fund, or with any other entity, including another adviser, and receives any compensation for the overall advisory services. As a result, the "for compensation" provisions of Article III, Section 40 would apply, thereby requiring the RR/RIA adviser to provide notice to his or her firm and requiring that firm, if it approved the activities, to record the transactions and supervise the conduct of the RR/RIA. The Board has determined to exclude from Section 40 coverage arrangements under which the account is "handed off' to unaffiliated third-party advisers that make all investment decisions. This, and most other advisory activities, would fall under and be subject to the requirements of Article III, Section 43 of the Rules of Fair Practice.

Activities that would fall under either Sections 40 or 43 of the Rules of Fair Practice can be generally categorized as follows:

1. Transactions executed on behalf of the customer in which the RR/RIA participated in the execution would be subject to the full "for compensation" provisions of Section 40, thereby requiring the member to record and supervise the transactions. This would be the case whether the RR/RIA received transactionally related, commission-type compensation, asset-based management fees, wrap fees, hourly, yearly, or per-plan fees, as long as fees paid include execution services by the RR/RIA. Also included are situations where the dually registered person has an arrangement with a third-party money manager to handle the customer's account and the RR/RIA makes individual investment decisions for the client, based on recommendations or alternatives provided by the third-party manager.

2. Only transactions executed on the customer's behalf without any form of compensation would be subject to the "non-compensation" provisions of Section 40. It is unlikely that activity of this sort would exist to any substantial degree outside of a familial type relationship.

3. All other investment advisory activities that do not include the RR/RIA's participation in the execution would be subject to the notification provisions of Article III, Section 43. These activities would include securities transactions executed by customers independently through another broker/dealer or directly with a fund or other entity based on specific recommendations of the dually registered person, timing services where the service makes the investment decision, the utilization of unaffiliated third-party advisers where the RR/RIA does not participate in investment decisions for the client, financial plan creation and other such activities.

Analysis Of Various Scenarios Under The Clarification

The following are issues raised in correspondence from members and the results under this interpretation.

1. A service offered by many discount brokerage firms includes the firm providing "back office" services for the dually registered person which include collection of the asset-based advisory fee. Here, the RR/RIA has opened an account on behalf of a customer and has discretionary authority to execute transactions on the customer's behalf. Under these facts, the "for compensation" of Section 40 would apply.

2. Some RR/RIAs engage in activities limited to the writing of financial plans for a fee which do not include specific securities purchase recommendations or executions. Under this approach, such activities would be governed by Section 43.

3. Some asset management firms offer "wrap fee" programs to registered investment advisers. The "wrap fee" includes a fee for management, accounting, and reporting. This fee is shared with the investment adviser who is also a registered representative. Portfolio transactions are handled through a broker/dealer firm at substantial discounts and are not known to or handled by the RR/RIA. Investment advisers receive a part of the asset management fee only and receive no part of any transaction fee. The adviser is registered with the SEC and any states as necessary. This activity would be subject to Section 43 rather than Section 40 of the Rules of Fair Practice.

4. There are firms offering market timing services where the firm, operating as an independent investment adviser, directs the switches within a family of mutual funds, either load or no-load. There are no transaction charges and the investment adviser, also a registered representative, is not involved in handling switches among funds. The dually registered person does receive some part/percentage of the market timing fee. If the customer or timing firm effects the switches with no involvement by the RR/RIA, this fact pattern would be considered as falling under Section 43.

5. Investment advisers who are also registered representatives often charge an advisory fee to "time" a group of load or no-load mutual funds for clients. This process could also be described as asset allocation or a monitoring service. The exchange of funds is handled directly by the investment adviser with the fund group. This pattern differs from number 4 in that the adviser effects the transactions. These are "for compensation" transactions pursuant to Section 40.

6. There are several firms which provide asset allocation models, software, computer hardware, and direct linkup and execute the transactions as necessary. Each adviser can produce statements for clients based on downloaded information. The RR/RIA receives a portion of the asset-based fee for his or her monitoring of the account. The firm to which the account is referred actually handles all implementation, and the dually registered person has no part in the actual transactions. These third-party arrangements are covered by Section 43.

7. Institutional advisers offer services to individual investment advisers which include permitting the adviser to implement, via computer, purchases and sales in institutional funds. Assets are held at banks and the RR/RIA produces statements and confirms for a client. The RR/RIA also handles the allocation of assets and places transactions. The client can pay one combined fee or two separate fees. One is paid to the mutual fund (internal fee) and the second is paid separately to the dually registered person for handling the account. To the degree that the RR/RIA participates in the execution of the transactions, this would produce a "for compensation" Section 40 result.

8. Investment advisers may advise clients on assets held and transacted at another broker/dealer without being involved in implementation or execution. The RR/RIA may receive copies of statements and charges an advisory fee which is for investment advice and monitoring not related to any transactions in the account. This scenario does not involve either the recommendation or execution of transactions. Since the service is solely advice and monitoring "not related to any transactions in the account," the activities would fall under Section 43.

9. Varying situation number 8, such that the adviser calls the representative of the other broker/dealer to implement or execute transactions but receives no fee or commission for the handling thereof, results in "for compensation" transactions under Section 40.

Members and RR/RIAs are expected to be in compliance with the Board's Interpretation as clarified in this Notice. Those firms and RR/RIAs who have not been operating in accordance with the provisions of *Notice to Members 91-32* must immediately conform their activities in order to ensure compliance with the concepts and requirements that have been clarified in this Notice. NASD district examiners will be closely reviewing for compliance with this Interpretation during the course of their field examinations, and violations will be reviewed by DBCCs for consideration of disciplinary action. This clarification should enhance members' abilities to design internal policies and procedures to protect customers who deal with dually registered persons and to prevent potential violations of NASD rules and regulations, particularly Article III, Section 40 of the Rules of Fair Practice. directed to Daniel Sibears, Director, Any questions or inquiries concerning the applicability of Article in, Section 40 to the activities of RR/RIAs may be directed to Craig Landauer, Associate General Counsel at (202) 728-8291. Questions relating to members' general compliance and recordkeeping responsibilities under Article III, Section 40 may be Regulatory Policy at (202) 7286911.

NASD Notice to Members 96-33

NASD Clarifies Rules Governing RR/IAs

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- ■ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- ■ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- ■ Training

Executive Summary

On May 15, 1994, the NASD® issued *Special Notice to Members 94-44*, which clarified the applicability of Article III, Section 40 of the NASD Rules of Fair Practice to investment advisory activities of registered representatives (RRs) who also are investment advisers (RR/IAs). In particular, the Notice addressed the supervision of securities transactions conducted by RR/IAs away from the NASD members with which they are associated. Since the issuance of *Notice to Members 94-44*, the NASD has responded to questions concerning the types of records that may be used and recordkeeping systems that may be established by an NASD member to ensure that investment advisory transactions subject to Article III, Section 40 are properly recorded and the RR/IA adequately supervised. The NASD also has responded to other general compliance and interpretive questions relating to Article III, Section 40. To further facilitate member firm compliance with Article III, Section 40, this Notice discusses recordkeeping approaches and presents the answers to some of the most frequently asked questions regarding Section 40 since the release of *Notice to Members 94-44*.

Questions regarding this Notice may be directed to Daniel M. Sibears, Director, Regulation, at (202) 728-6911; or Mary Revell, Senior Attorney, Regulation, at (202) 728-8203.

Background

As reviewed in *Notice to Members 94-44*, Article III, Section 40 requires that any person associated with an NASD member who participates in a private securities transaction must, before participating in the transaction, provide written notice to the member with which he or she is associated. The written notice must describe the transaction, the associated person's role, and disclose whether the associated person will or may receive selling compensation. Thereafter, the NASD member must advise the individual in writing whether it approves or disapproves the associated person's participation in a private securities transaction. If the member approves the transaction, the transaction must be recorded on the member's books and records, and the member must supervise the associated person's participation as if the transaction were executed on behalf of the member.

Most notably, *Notice to Members 94-44* clarifies the analysis that members must follow to determine whether the activity of an RR/IA falls within the parameters of Section 40. Fundamental to this analysis is whether the RR/IA participates in the execution of a securities transaction such that his or her actions go beyond a mere recommendation, thereby triggering the recordkeeping and supervision requirements of Section 40.

Where the RR/IA does not participate in the execution of securities transactions, *Notice to Members 94-44* reminds members and their RR/IAs that while Section 40 may not apply, the activity, nonetheless, may be subject to the notification provisions of Article III, Section 43. That section requires an RR to provide written notice to the NASD member with which he or she is associated of any proposed employment or outside business activity pursuant to which he or she will receive compensation from others. The form and content of an Article III, Section 43 notice is to be determined by the NASD member.

Article III, Section 40 Books And Records Relating To Investment Advisory Transactions

Where a member has approved an RR/IA's participation in private securities transactions for which he or she will or may receive selling compensation, the member must develop and maintain a recordkeeping system that, among other things, captures the transactions executed by the RR/IA in its books and records and facilitates supervision over that activity. Recordkeeping systems that simply record all transactions will not result in adequate supervision under Article III, Section 27 of the Rules of Fair Practice. Rather, the records created and recordkeeping system used, together with relevant supervisory procedures, must enable the member to properly supervise the RR/IA by aiding the member's understanding of the nature of the service provided by an RR/IA, the scope of the RR/IA's authority, and the suitability of the transactions.

Since the transactions subject to Section 40 by definition occur at and through another member or directly with a product sponsor, the NASD member licensing the RR/IA is not required to record the activity in the same manner it records transactions executed on behalf of its own firm (i.e., on its purchase and sales blotter). Rather, members may develop and use alternative approaches that meet their specific needs and business practices, such as special blotters, separate Section 40 recordation forms and files, and unit systems, for capturing the RR/IA activity that occurs through other firms. In this regard, Section 40 recordkeeping systems may involve many of the following books and records:

- dated notifications from the RR/IA detailing the services to be performed by the RR/IA and the identity of each RR/IA customer serviced at another firm in a private securities transaction;
- dated responses from the NASD member to the RR/IA acknowledging and approving or disapproving the RR/IA's intended activities;
- a list of RRs who also are IAs;
- a list of RR/IAs approved to engage in private securities transactions;
- a list of RR/IA customers, including those that are customers of both the member firm and the RR/IA, with a cross reference to the RR/IA;
- copies of customer account opening cards to determine, among other things, suitability;
- copies of discretionary account agreements;
- duplicate confirmation statements;
- duplicate customer account statements;
- a correspondence file for RR/IA customers;
- investment advisory agreements between the RR/IA and each advisory client;
- advertising materials and sales literature used by the RR/IA to promote investment advisory services wherein the RR/IA holds himself or herself out as a broker/dealer, complemented by a process that shows whether proper filings have been made at the NASD and whether the RR/IA is using any electronic means, such as the Internet, to advertise services or correspond with customers;
- exception reports, where feasible, based on various occurrences or patterns of specified activity, such as frequency of trading, high compensation arrangements, large numbers of trade corrections, and cancelled trades; and
- supervisory procedures fully responsive to Article III, Section 27 requirements and designed to address Section 40 compliance. The procedures may include such items as the identity of persons responsible for Section 40 compliance, the recordkeeping system to be used and followed, and memoranda or compliance manuals that notify RR/IAs of the member's procedural requirements for Section 40 compliance.

Neither the federal securities laws nor the NASD Rules of Fair Practice mandate the supervisory system or structure that a member must use. Rather, each member can develop and implement its own supervisory system that is reasonably designed to detect and prevent violations. In this regard, no single document or combination of the referenced documents is specifically required or necessarily adequate to comply with Section 40 requirements. Rather, each member that determines to permit its associated persons to transact securities business through another broker/dealer must decide which tailored combination of records is necessary to develop an adequate supervisory system that addresses the allowable activities of RR/IAs. For example, obtaining duplicate confirmation statements directly from the RR/IA alone would permit a member to fulfill recordation requirements for the trades represented by confirmations received, but would not necessarily permit a member to reasonably ensure that it is capturing all trades. However, an arrangement under which the member obtains duplicate confirmation statements directly from the firm (or firms) that executes transactions for the RR/IA should be sufficient to ensure that the member captures all trades.

Member firms have tremendous flexibility to develop and implement recordkeeping and supervisory systems that meet the unique nature and scope of their own operations, and the permitted activities and services provided by their dually registered persons. In all circumstances, however, recordkeeping and supervision must be adequate to ensure that full and complete transaction information is captured, and be reasonably designed to detect and/or prevent misconduct that could violate the federal securities laws and NASD Rules.

Answers To Frequently Asked Questions Concerning The Application Of Article III, Section 40 To Investment Advisory Activities

Question #1: Does Article III, Section 40 require prior approval of each transaction executed by an RR/IA away from his or her NASD member firm if the compensation received by the RR/IA is not transaction based?

Answer: An RR/IA may be involved in numerous transactions on a daily basis for which he or she receives asset-based or performance-based fees. Requiring prior notice of each trade effected under these conditions may hinder investors from properly receiving the investment advisory services provided by RR/IAs. Accordingly, the Board of Governors, acting on the recommendation of a special Ad Hoc Committee, has interpreted Article III, Section 40 to require prior notice of the investment advisory services that will be provided by the RR/IA for an asset-based or a performance-based fee, rather than prior notice of each trade effected by an RR/IA for a particular customer. This interpretation is intended to vigorously apply the investor protection concepts of Article III, Section 40 to investment advisory activities in a practical manner.

A member must receive prior written notice from an RR/IA requesting approval to conduct investment advisory activities for an asset-based or performance-based fee on behalf of each of his or her advisory clients. This notice must include details such as:

- a declaration that the individual is involved in investment advisory activities;

- the identity of each customer to whom the notice would apply;

- the types of securities activities that may be executed away from the firm;

- a detailed description of the role of the RR/IA in the investment advisory activities and services to be conducted on behalf of each identified customer;

- information regarding the RR/IA's discretionary trading authority, if any;

- compensation arrangements;

- the identity of broker/dealers through which trades away will be executed; and

- customer financial information.

Only after written approval from the NASD member may the RR/IA engage in the disclosed activities. If there is a change in the RR/IA's proposed role or activities for any customer from what the member initially approved, the RR/IA must provide the member with a subsequent written notice that details the changes and requests the member's further approval to conduct advisory activities on behalf of the customer. The employer member must thereafter record subsequent transactions on its books and records and supervise activity in the affected accounts as if it were its own.

Members are reminded, however, that if the RR/IA receives transaction-based compensation, the member's prior approval of each trade is required.

Question #2: Does Article III, Section 40 apply to persons employed by or associated with registered investment advisory firms if such persons are not registered in an individual capacity with the Securities and Exchange Commission (SEC) or various states?

Answer: Yes. Article III, Section 40 of the Rules of Fair Practice applies to all of an associated person's private securities transactions, regardless of whether or not such associated persons are also registered with other regulatory authorities such as the SEC or the states. The reference to registered investment advisers in *Notice to Members 94-44* does not limit the applicability of Article III, Section 40 to only those persons individually registered as such with other regulatory entities. In addition, if the advisory service is not registered with any regulatory agency, a member should ensure that such registration is not required.

Question #3: Is it appropriate for a limited principal (i.e., a Series 26 Investment Company Principal) to supervise Article III, Section 40 transactions in products such as equity securities that are not covered by that registration category?

Answer: Limited principals may not supervise Article III, Section 40 transactions in products not covered by their registration category. Therefore, if a firm only has principals registered in a limited capacity, associated persons engaging in Article III, Section 40 transactions may do so only in products covered by the licenses of the firm's principals.

Question #4: Is it appropriate for a limited representative (i.e., a Series 6 Investment Company Representative) to execute Article III, Section 40 transactions in products such as equity securities that are not covered by that registration category?

Answer: A limited RR who is otherwise in compliance with applicable federal and state registration requirements, such as the SEC's investment adviser registration requirements, may not execute transactions in securities not covered by his or her NASD registration. Registration with the NASD as a representative subjects an individual to all NASD rules, regulations, and requirements, including qualification requirements. Those rules preclude a limited representative from acting as a representative in any area not covered by his or her registration category. A limited representative who wishes to execute transactions in securities not covered by his or her registration category is required to pass an appropriate qualification exam.

Question #5: If an RR/IA is registered with more than one NASD member, must all members approve, supervise, and record the Article III, Section 40 transactions?

Answer: All members with whom a person is registered are responsible for the registered representative's involvement in Section 40 transactions. Members may develop a detailed, formal allocation arrangement whereby at least one member agrees and is able to provide the supervision and recordkeeping required by Article III, Section 40. However, the other members would be required to take the reasonable steps necessary to ensure that Section 40's recordkeeping and supervisory requirements are being carried out since members cannot delegate, by contract or otherwise, their ultimate responsibility for compliance with regulatory requirements.

Question #6: What is a member's responsibility with regard to supervising Section 40 securities transactions where an advisory client of an RR/IA refuses to provide information to the member, citing the confidentiality of client information provisions of an investment advisory agreement?

Answer: Article III, Section 40, which was adopted in 1985, and its predecessor Interpretation of the Board of Governors have always stipulated that a member that allows an associated person to participate in a Section 40 transaction is responsible for supervising that transaction as if it were its own. If a member determines that in order to meet its supervisory obligations under Section 40, it must have certain information from the customer and if the customer refuses to provide the information, the member should deny the associated person's request who would then be precluded from participating in the Section 40 activity.

Question #7: Are there circumstances under which income received as salary payments may be deemed selling compensation as defined by Article III, Section 40?

Answer: As explained in *Notice to Members 94-44*, selling compensation is broadly defined to include any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security. If salary payments are direct or indirect compensation for an RR/IA's participation in the execution of securities transactions away from his or her member firm, the salary payments would be deemed "selling compensation," and the activities would be subject to Article III, Section 40.

Question #8: Where investment seminars are conducted by RR/IAs away from their employing NASD member and seminar participants are charged a fee for attendance, would any income derived from the seminar for this investment advisory activity be governed by Article III, Section 40 or Section 43 of the Rules of Fair Practice?

Answer: If an investment seminar itself does not result in the execution of securities transactions, Article III, Section 43 would govern the investment advisory activity. In determining whether Article III, Section 40 applies, the NASD has focused primarily upon the RR/IA's participation in the execution of securities transactions and whether the participation goes beyond a mere recommendation. If after an investment seminar, however, participants decide to engage in securities transactions with the participation of the RR/IA, that subsequent activity and any compensation received in connection therewith would be subject to Section 40.

Question #9: Must a member review performance reports produced by RR/IAs to properly discharge its supervisory responsibilities under Article III, Section 40?

Answer: It has come to the NASD's attention that some RR/IAs use information supplied by the broker/dealer through which they conduct private securities transactions or by the investment advisory service corporations with which they are associated to create performance reports for their advisory clients. These reports may be individualized performance reports that provide customized information for a specific client or standardized performance reports that provide general information to multiple clients. With regard to this practice, members and RR/IAs are cautioned that in creating or recreating performance reports, a risk is taken that calculations for securities transactions may be inaccurate, incomplete, or misleading, thus resulting in material misrepresentations being made or material facts being omitted. NASD member supervisory responsibilities should include a determination as to whether to permit associated persons to develop performance reports for securities transactions. If this activity is permitted, the member firm must review the performance reports.

Standardized reports sent to multiple clients are considered sales literature and must be reviewed by a registered principal at the member firm before distribution by the RR/IA to clients. If the RR/IA uses the same standardized format for different clients, principal approval before use is required only on the performance report prototype. This review must ensure that the reports are accurate, not misleading, or otherwise in violation of NASD or SEC Rules. In particular, members should review the standards set forth in Article III, Section 35 of the NASD Rules governing member communications with the public, as well as applicable SEC regulations.

Individualized performance reports are considered correspondence. As such, review by the member firm before RR/IA distribution to clients is not required. However, the firm must have appropriate procedures in place, as required by Article III, Section 27 of the NASD Rules of Fair Practice, for review and retention of individualized performance reports and other correspondence.

Question #10: Must NASD members that employ RR/IAs provide training to this segment of their associated persons under the Firm Element of the Continuing Education requirements?

Answer: The Firm Element of the Continuing Education requirements (see Schedule C of the NASD By-Laws) is designed to be flexible and to permit firms to develop tailored educational programs based on their business practices and needs. In this regard, each member that permits its associated persons to conduct securities transactions through another firm should assess the need to provide specific Firm Element training with regard to Section 40 requirements. Where the assessment establishes a need for educational initiatives for all or some portion of the covered persons conducting business away from the member, the firm's written training plan should include defined and scheduled Section 40 training for specified individuals.

Although this Notice and previously issued *Notices to Members 91-32* and *94-44* clarify the application of Article III, Section 40 to investment advisory activities, Section 40 has been in effect since November 12, 1985 (see *Notice to Members 85-84*). Accordingly, members and their RR/IAs are expected to be in compliance with Article III, Section 40.

PowerPoint Presentation:

Investor Education and Protection

By Shannon Stone, Caley Love, Chris Mann, and Jason Vinsonhaler

Slide 1

OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Investor Education and Protection

Shannon Stone   Caley Love   Chris Mann   Jason Vinsonhaler

Kansas
Office of the Securities Commissioner

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Slide 2

KSC Mission

- The mission of the Office of the Kansas Securities Commissioner (KSC) is to **protect and inform Kansas investors;** to promote integrity, fairness, and full disclosure in financial services; and to foster capital formation.

Kansas
Office of the Securities Commissioner

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Slide 3

Protect and Inform Kansas Investors by:

- Encouraging investors to check the registration status of companies and persons offering investments or investment advice in Kansas
- Investigating potential violations of state securities laws and regulations
- Prosecuting individuals who commit securities fraud
- Providing investor education resources to the public
- Registering broker-dealers, agents, investment advisers, and representatives
- Registering securities offerings, unless exempt

Kansas
Office of the Securities Commissioner

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Slide 4

Legal Background

- Kansas Uniform Securities Act (KUSA):
  - K.S.A. 17-12a601 (d) 1-2 (recently amended)
  - Investor Education Initiatives
    - To inform the public about financial literacy and investing, with emphasis on prevention and detection of securities fraud
  - Investor Education and Protection Fund
    - Moneys collected from civil penalties and settlements from cases

Kansas Office of the Securities Commissioner

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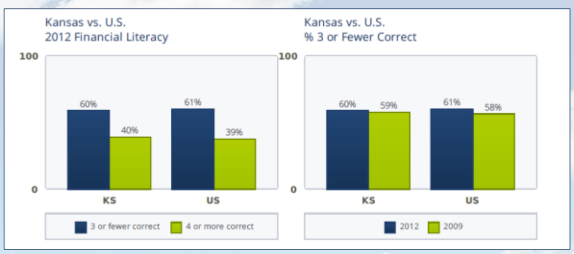
Slide 5

A Need for Financial Education

Results from 2012 FINRA 5-Question Survey



Only 40% of Kansans would've received a passing score on this very basic financial knowledge quiz.

Kansas Office of the Securities Commissioner

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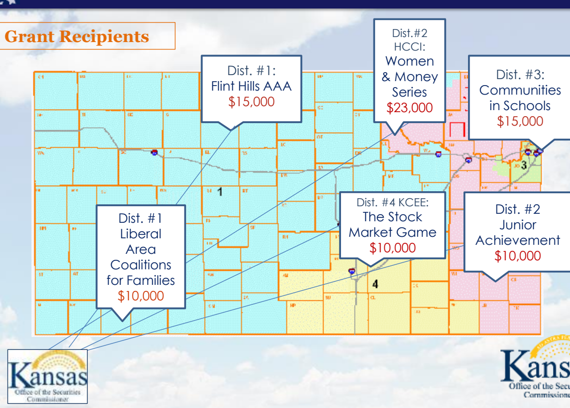
Slide 6

Investing in Kansans

2014 Grant Recipients



Kansas Office of the Securities Commissioner

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Slide 7

Investing in Kansans: How to Get Involved

- Help identify quality, effective programs and organizations that may qualify for funding through our grants program.
- Support existing programs by volunteering with our partners and area schools.

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Kansas
Office of the Securities Commissioner

Slide 8

Reality U: Communities in Schools of Mid-America

Reality U focuses on student preparation for an employable future. It is a multi-day financial literacy exercise that provides a hands-on learning experience in a simulation setting for students to prepare them for life after high school.

School districts across the state are requesting this program. Communities in Schools is working diligently to meet the demand.

With the help of 498 volunteers, Reality U served 3,688 students during the 2013-14 school year. This year Reality U is poised to serve well over 4,000 students.

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Kansas
Office of the Securities Commissioner

Slide 9

Junior Achievement

- Mission: To help students prepare for the real world of the future and help them learn the skills they need for success.
- Junior Achievement of Kansas will work with nearly 28,000 children this school year in Shawnee, Douglas, Sedgwick, Jackson, Nemaha, Marshall and Phillips counties.
- Volunteer mentors help students to:
  - Manage finances
  - Develop in-demand job skills
  - Discover the spirit of entrepreneurship

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Kansas
Office of the Securities Commissioner

Slide 10

Women & Money Series
Housing & Credit Counseling of Topeka

7-week series developed by women for women, designed to:

- ✓ increase women's financial knowledge
- ✓ aid women's confidence in decision-making
- ✓ help women gain control of their life through informed money management

Topics Covered:
Budgeting, Saving, Banking, investment products, Investor rights/responsibilities, Risk tolerance, Avoiding fraud, Choosing a financial planner, etc.

Audience:
122 women enrolled in 2013. Ages 22-60's, Diverse ethnicities. Low to moderately high incomes.

Recently expanded Series to Johnson County

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Kansas Office of the Securities Commissioner

Slide 11

Flint Hills Area Agency on Aging

- The North Central-Flint Hills Area Agency on Aging, Inc. plans, coordinates and sponsors services in 18 north central Kansas counties to enhance the quality and dignity of life for older Kansans and their families.

Seniors are a prime target for con-artists.

- *Keynotes* publication articles
- Answers for Older Kansans workshops
- *Keeping Kansans in the Game* initiative

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Kansas Office of the Securities Commissioner

Slide 12

Financial Peace, Jr.

Children's series which teaches character and the foundational principles of personal money management including: working, budgeting, avoiding debt, saving, generosity and integrity. Recommended for ages 6-12.

Our office started supporting this program in classrooms in KCK in 2012, and are looking to expand it on a per-request basis.

➢ **Refer a teacher. We will either present lessons once a week to the class or we'll purchase the program for the teacher.**

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Kansas Office of the Securities Commissioner

Slide 13

Slide 14

Slide 15

Slide 16

How You Can Help

- Report Questionable Investments and Practices
  - Name and contact information for both the person offering the security and the person to whom the offer was made
  - Note the name of the investment and terms of the offer
  - Gather any documents provided
  - Submit all documents and information to KSC

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Slide 17

How You Can Help

- Questionable Investment Red Flags
  - "Guaranteed" or "Risk Free" Claims
  - Unusually High Rate of Return
  - Minimal Documentation Provided
  - Unsolicited Contact Offering Securities
  - Pressure for Immediate Decision or Payment

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Slide 18

Investor Education and Protection

Questions?

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Kansas
Office of the Securities Commissioner

Supplemental Materials:

Investor Education and Protection

By Shannon Stone, Caley Love, Chris Mann, and Jason Vinsonhaler

AD ASTRA PER ASPERA

Kansas

Office of the Securities Commissioner

Enrolled Version of HB 2433: Changes to K.S.A. 17-12a601(d) effective July 1, 2014
Investor Education and Protection

(d) *Investor education and protection.* (1) The administrator may develop and implement investor education *and protection* initiatives to inform the public about investing in securities~~, with~~ *and protect the public from violations of the Kansas uniform securities act, K.S.A. 17-12a101 et seq., and amendments thereto. Such initiatives shall have a* particular emphasis on the prevention~~ and~~, detection*, enforcement and prosecution* of securities fraud. In developing and implementing these initiatives, the administrator may collaborate with public and nonprofit organizations with an interest in investor education *or protection*. The administrator may accept a grant or donation from a person that is not affiliated with the securities industry or from a nonprofit organization, regardless of whether the organization is affiliated with the securities industry, to develop and implement investor education *and protection* initiatives. This subsection does not authorize the administrator to require participation or monetary contributions of a registrant in an investor education program.

(2) There is hereby established in the state treasury the investor education *and protection* fund. Such fund shall be administered by the administrator for the purposes described in subsection (d)(1) and for the education of registrants, including official hospitality. Moneys collected as civil penalties under this act shall be credited to the investor education *and protection* fund. The administrator may also receive payments designated to be credited to the investor education *and protection* fund as a condition in settlements of cases arising out of investigations or examinations. All expenditures from the investor education *and protection* fund shall be made in accordance with appropriation acts upon warrants of the director of accounts and reports issued pursuant to vouchers approved by the administrator or by a person or persons designated by the administrator. ~~Two years after the effective date of this act, the administrator shall conduct a review and submit a report to the governor and the legislature concerning the expenditures from the investor education fund and the results achieved from the investor education program.~~

Sec. 3. K.S.A. 2013 Supp. 17-12a508 and 17-12a601 are hereby repealed.

Sec. 4. This act shall take effect and be in force from and after its publication in the statute book.

I hereby certify that the above BILL originated in the HOUSE, and was adopted by that body

____

HOUSE adopted
Conference Committee Report ____________________

____
Speaker of the House.

____
Chief Clerk of the House.

Passed the SENATE
as amended ____________________

SENATE adopted
Conference Committee Report ____________________

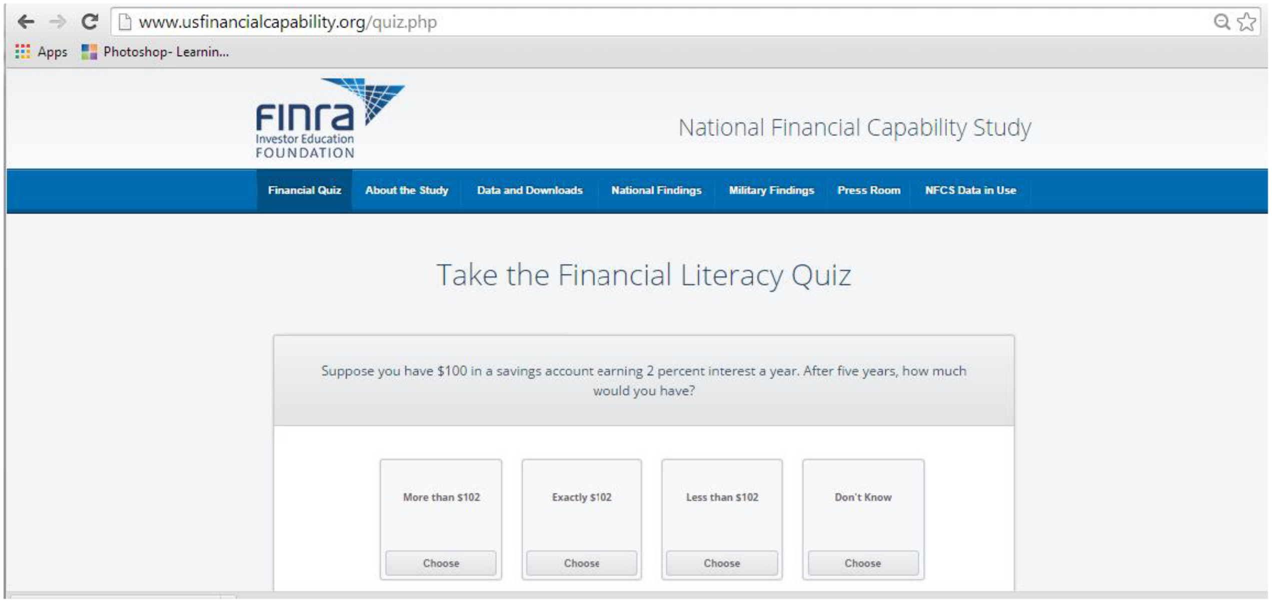
____
President of the Senate.

____
Secretary of the Senate.

APPROVED ____________________

____
Governor.

FINRA 5-Question Financial Literacy Survey



Questions:

1. Suppose you have $100 in a savings account earning 2 percent interest a year. After five years, how much would you have?

   More than $102 **Exactly $102** **Less than $10** **Don't Know**

2. Imagine that the interest rate on your savings account is 1 percent a year and inflation is 2 percent a year. After one year, would the money in the account buy more than it does today, exactly the same or less than today?

   More **Same** **Less** **Don't Know**

3. If interest rates rise, what will typically happen to bond prices? Rise, fall, stay the same, or is there no relationship?

   Rise **Fall** **Stay the Same** **No Relationship** **Don't Know**

4. True or false: A 15-year mortgage typically requires higher monthly payments than a 30-year mortgage but the total interest over the life of the loan will be less.

   True **False** **Don't Know**

5. True or false: Buying a single company's stock usually provides a safer return than a stock mutual fund.

   True **False** **Don't Know**

2711 W. 6th Street, Suite E
Lawrence, KS 66049

PH: 785.856.5190
www.cismidamerica.org

Communities In Schools
Mid-America

Reality U is coming to high schools across Kansas and we need your experience and expertise!!!

WHAT IS REALITY U?

At Reality U, students will be provided an occupation based on their educational plans after high school, their current GPA, and their desired career field. They will fill out a Lifestyle Survey prior to the event, providing details about the life they plan to have as a 26 year-old.
Before entering Reality U, they will receive their adult scenario – complete with marital status, number of children, career field, and net monthly income.

At Reality U students will visit a variety of booths to "purchase" housing, transportation, communication services, child care, food, utilities, insurance etc. They will also have the opportunity to save and invest money, give to charity and learn about unexpected things that affect daily life (e.g. accidents, unexpected visitors).

UPCOMING EVENTS ACROSS KANSAS THIS FALL

F.L. Schlagle HS (KC)	10/16
Topeka HS	10/29 & 10/30
Ashland HS	11/4
Liberal HS	11/5
Hope Street Academy (Topeka)	11/7
Wyandotte HS (KC)	11/13
Lawrence HS	11/19 & 11/20
Ottawa HS	12/02
J.C. Harmon HS (KC)	12/11 & 12/12
Washington HS (KC)	12/17 & 12/18

With the help of 498 volunteers, Reality U served 3,688 students during the 2013-14 school year. This year Reality U is poised to serve well over 4,000 students!

VOLUNTEERS NEEDED—Volunteers help students make wise financial choices regarding the necessities and luxuries they imagine as part of their adult lifestyle. They are provided with detailed information needed to help students during the event.

To volunteer for one or more events or find out how you can help support RU, contact

Sophie Archuleta
sophie.archuleta@cismidamerica.org
785-856-1939

VOLUNTEERING WITH JA OF KANSAS

GIVE KANSAS KIDS A BRIGHTER FUTURE

Empower young people to own their economic success

Help give students the tools they need to succeed in a global economy by helping Junior Achievement of Kansas provide age-appropriate financial literacy, entrepreneurship and work readiness education to children to ensure successful economic and workforce development for Kansas.

Your time commitment is 5-7 hours over the course of one to six weeks, depending on the grade you choose. JA staff will help train and prepare you for the classroom. All program materials are provided. You provide your real-world expertise and experience!

Give back to your community while building its future workforce. Volunteer with Junior Achievement of Kansas!

CONTACT US TO LEARN MORE:

785.235.3700 | www.KansasJA.org

Junior Achievement of Kansas

JUNIOR ACHIEVEMENT OF KANSAS:

Delivered the program to **1,170** classes, reaching nearly **25,000** students statewide during the 2013-14 school year.

In 2014-15, we are on target to deliver the program to nearly **26,000** students.

Trained and placed **969** volunteers from **185** businesses into classrooms across the state.

HELP US MAKE A DIFFERENCE FOR KIDS:

Twice as many JA Alumni own their own businesses as their peers who did not have JA.

JA students are more likely to **understand the importance of education** and finish high school.

95% of teachers who have had JA in the classroom say JA students develop a better understanding of how the world operates.

About HCCI
www.hcci-ks.org
1-800-383-0217

Housing and Credit Counseling, Inc. (HCCI) was founded in 1972 as a 501(c)(3) nonprofit agency. HCCI provides HUD approved housing and consumer credit counseling and financial literacy education for about 7,500 people annually. HCCI serves Kansas through its offices in Topeka, Lawrence, and Manhattan.

Programs include counseling and education about budgeting, debt management and debt repayment, credit building, mortgage default, rent delinquency, options for student loan repayment, reverse mortgages for seniors, and bankruptcy education approved by the Executive Office of the United States Trustee. HCCI also offers an award winning Homebuyer Eduation Program. HCCI provides Rental Housing Counseling and Education for tenants and landlords.

Recent Awards

Better Business Bureau 2013 Integrity Award

In 2013, the Better Business Bureau of the Great Plains selelcted HCCI as the first nonprofit agency in Kansas to receive the BBB Integrity Award. Denise Groene, Kansas State Director for the BBB, said HCCI stood out because of "their commitment to the community and their pledge to value business ethics, integrity and trust within their organization."

2012 National Debt Management Counseling Agency of the Year

In 2012, the National Foundation for Credit Counseling honored HCCI for the expert debt management counseling provided to a couple since 2006. With counseling from HCCI, this remarkable couple paid off more than $118,000 in debt over five years though hard work and dedication to meet their financial obligations. HCCI is extremely proud to have them named as National Clients of the Year for 2012. In 2010 the National Foundation for Credit Counseling also named HCCI staff as a Financial Literacy Educator of the Year.

2010 Kansas Ad Astra Award

HCCI has developed an award winning First-Time Homebuyer Education and Counseling Program. The Kansas Housing Resource Corporation recognized HCCI with the 2010 State Ad Astra Award for outstanding leadership in helping Kansas families realize the American Dream of homeownership. The award acknowledges the extensive partnerships HCCI has built with the City of Topeka, Federal Home Loan Bank of Topeka, and Capitol Federal to initiate the TOTO (Topeka Opportunty To Own) Program that has made it possible for over 450 Topeka low-income families to realize the American Dream and purchase their own TOTO home.

HCCI is certified by HUD and accredited by the Council on Accreditation of Services for Families and Children. HCCI is a member of the National Foundation for Credit Counseling and is registered and regulated in Kansas by the Office of the State Bank Commissioner.

9/26/2014

Serving older Kansans and their families in the Heartland of Kansas.

Chase
Clay
Cloud
Dickinson
Ellsworth
Geary
Jewell
Lincoln
Lyon
Marion
Mitchell
Morris
Ottawa
Pottawatomie
Republic
Riley
Saline
Wabaunsee

North Central-Flint Hills
AREA AGENCY ON AGING, Inc.
401 Houston St.
Manhattan, KS 66502

785-776-9294 or
800-432-2703

"Real help. Real people. Real time."

Fax: 785-776-9479
Website: www.ncfhaaa.com
E-mail: ncfhaaa@ncfhaaa.com
TDD Relay for hearing impaired:
800-766-3777

The North Central-Flint Hills Area Agency on Aging, Inc. is a private, non-profit organization that plans, coordinates and sponsors services in 18 counties to enhance the quality and dignity of life for older Kansans and their families. The Area Agency programs and services are partially funded by the Older Americans Act through the Kansas Department for Aging and Disability Services and voluntary participant contributions. The Area Agency works in partnership with local and county governments and senior citizens. All services are available without regard to race, color, national origin, sex, age or disability. For more information, call 800-432-2703 or 785-776-9294.

North Central-Flint Hills
AREA AGENCY ON AGING, Inc.

401 Houston St.
Manhattan, KS 66502

785-776-9294 or
1-800-432-2703

Services for seniors and caregivers offered by the North Central-Flint Hills Area Agency on Aging

Answers on Aging

- Presentations and seminars on Medicare, consumer scams and other issues important to seniors, people with disabilities and caregivers
- Conversations with seniors, caregivers and families to address questions or concerns and provide "answers on aging"
- Help with understanding public benefits, cutting through red tape and completing paperwork and forms
- Referrals to others in the community who can provide support or assistance
- Help with family members' health insurance questions

Support for Family Caregivers

- Monthly family caregiver newsletter
- Monthly family caregiver "radio talk show" call – dial in, listen, talk if you want
- Workshops with helpful, practical resources and advice to family caregivers

Senior Health Insurance Counseling for Kansas (SHICK)

- Assistance with selecting or changing a Medicare Part D Prescription Drug Plan
- Helpful information about Medicare, Medigap plans and long-term care insurance
- Help with solving Medicare-related problems

Be Well! Stay Well!

- Seminars and sessions that provide proven stratagies to maintain your balance and well-being

Friendship Meals

- Food and friendship at 44 area dining centers
- Home-delivered or frozen meals for seniors
- Meals and a friendly knock on the door that help family caregivers!

Long-Term Care Services and Case Management

- Comprehensive assessments to identify care needs of seniors, people with disabilities and their caregivers
- Plans of care designed by professional case managers to maintain safety, independence and dignity at home
- Coordination of an array of in-home services to meet the needs of older Kansans and people with disabilities
- *Right At Home Solutions* in-home care coordination service

Older Kansans Employment Program (OKEP)

- Help for people 55 or older seeking jobs
- Information and skill enhancement for job-seekers through computer technology
- Connecting employers with job-seekers

Foster Grandparents Program

- Tutoring and mentoring by older Kansans for at-risk school children in select counties

Sunflower Fair!

- The heartland's premier health and wellness event every September

Keynotes News Magazine

- "*News You Can Use and Information You Can Trust*" about Medicare, legal matters, and federal, state and local issues
- Sent to more than 40,000 households of seniors, caregivers and businesses
- Supported by reader contributions and advertising

Flint Hills Housing Assistance

- Section 8 low-income rental assistance
- Security and utility deposit assistance

Volunteer Opportunities

- Call 1-800-432-2703 or 785-776-9294 to learn about ways you can help your older friends and neighbors!

North Central-Flint Hills
AREA AGENCY ON AGING, Inc.

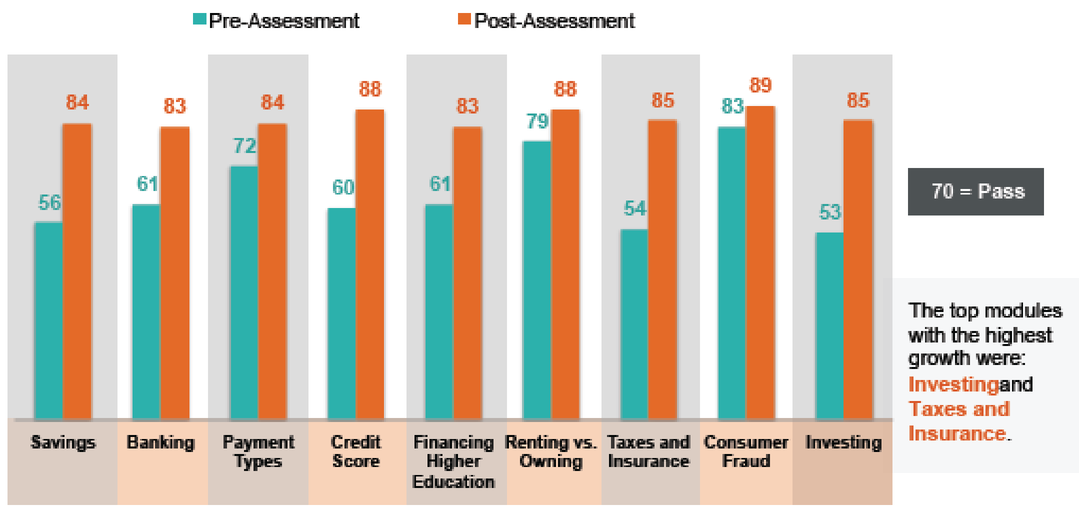
401 Houston St.
Manhattan, KS 66502
1-800-432-2703 or 785-776-9294
www.ncfhaaa.com

"Real help. Real people. Real time."

EverFi Kansas Financial Scholars Program: Schools Spread Map and Knowledge Gains Chart

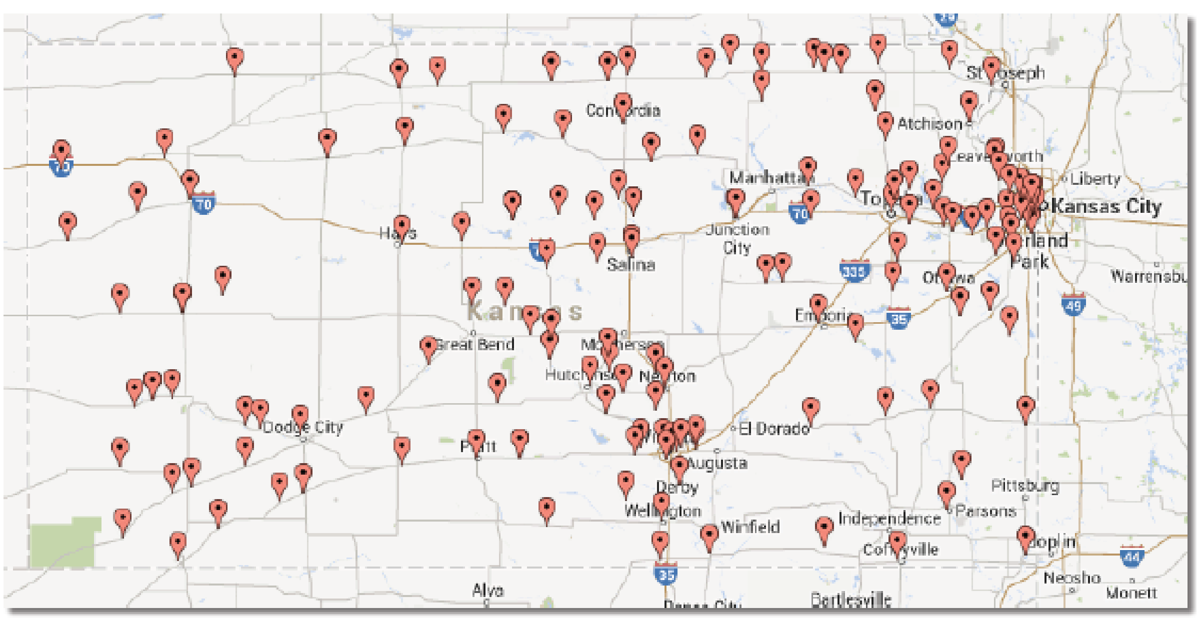
Knowledge Gains

OVERALL KNOWLEDGE GAIN	Pre-Assessment	Post-Assessment	Increase
	64	85	33%



Knowledge Change	50%	36%	17%	47%	36%	11%	57%	7%	60%

Impacting Students Across the State at Scale



Kansas
Office of the Securities Commissioner

109 SW 9th Street
Suite 600
Topeka, KS 66612

Phone: (785) 296-3307
Fax: (785) 296-6872
Investor Services: 1-800-232-9580
www.ksc.ks.gov

Joshua A. Ney, Commissioner
Sam Brownback, Governor

SECURITIES COMPLAINT FORM

The purpose of the form is to provide the information needed to start a preliminary investigation of a complaint. It is important to provide as much detailed information as possible.

1. YOUR INFORMATION

□ Mr. □ Mrs. □ Miss □ Ms. D.O.B. ___/___/___

Name ______________________________________

Home Address ________________________________

City _________________State ___ Zip ___________

Home Phone _________________________________

Occupation __________________________________

Business Address _____________________________

City _________________State ___ Zip __________

Business Phone ______________________________

E-Mail Address ______________________________

Fax Number _________________________________

2. WHO IS YOUR COMPLAINT AGAINST?

Business Name___________________________

____

Address__________________________________

City ________________State ___ Zip ________

Phone ___________________________________

E-Mail/Web Site __________________________

Individuals You Dealt With:

Name ____________________________________

Title _____________________________________

Name ____________________________________

Title _____________________________________

3. TRANSACTION INFORMATION

Date of Transaction/Purchase: ___/___/___ Product Involved: ____________________________________

What was the transaction for? □ Myself □ My Business □ My Corporation □ My Family/Household

Amount Paid: $_____________ Paid By: □ Cash □ Check □ Credit Card □ Loan □ Direct Deposit

What was the date of the payment? ____

Who received the payment from you? ____

How many units or shares did you purchase? ____

Did you sign a contract? □ Yes □ No Did you have a verbal agreement? □ Yes □ No

Where did the transaction take place? (Check one)

□ Over the phone □ At Home □ At the Company □ By Mail □ Other ______________________________

Had you any prior business relationship with either the company or the salesperson who contacted you?

□ Yes □ No If yes, please explain: ____

____

What was the first contact between you and the company? (Check one)

□ Person came to my home □ I telephoned the company □ I responded to a radio/TV ad/mailing

□ I responded to an email □ I received a phone call from the company □ I responded to an internet ad

□ Other (Please explain) ____

____

4. PLEASE PROVIDE ADDITIONAL DETAILS REGARDING YOUR COMPLAINT ON A SEPARATE PAGE.

5. ACTIONS YOU HAVE TAKEN

Do you know of any other persons who invested with the company, corporation or association? If so, please provide their name, address and telephone number: ____

____

Have you notified or filed a complaint with any other agency? If yes, please describe: ________________________

____

Have you complained to the subject or seller? □ Yes □ No

If yes, what offer of adjustment or explanation was made? ____

____

Who made the offer of adjustment? ____

What would you consider to be a satisfactory solution? ____

____

6. DOCUMENTATION OF COMPLAINT

Please provide copies of all documents relevant to this complaint, including advertising material, contracts, receipts, letters, checks (front and back), statements, etc. FAILURE TO PROVIDE ALL RELEVANT DOCUMENTS MAY CAUSE UNNECESSARY DELAY IN THE HANDLING OF YOUR COMPLAINT.

Please return this complaint form and all attachments to:

Director of Enforcement
Office of the Kansas Securities Commissioner
109 SW 9th Street, Ste. 600
Topeka, KS 66612

Supplemental Materials:

Responding to a Regulatory Investigation

By Jeff Kruske, Tom Piccone, Amy Rush, and Jeff Jamieson

Kansas
Office of the Securities Commissioner

There is no PowerPoint for this presentation.

109 SW 9th Street
Suite 600
Topeka, KS 66612

Kansas
Office of the Securities Commissioner

Phone: (785) 296-3307
Fax: (785) 296-6872
Investor Services: 1-800-232-9580
www.ksc.ks.gov

Joshua A. Ney, Interim Commissioner

Sam Brownback, Governor

Final Target Letter

1. Provide a copy of each version of the Firm's Written Supervisory Procedures ("Firm's WSP") in effect from **DATE to DATE** (the "Relevant Period").
2. Identify the supervisory policies and procedures in effect during the Relevant Period concerning leveraged and/or inverse ETFs ("Non-Traditional ETFs"). Your response should identify where in the Firm's WSP this information is located.
3. Did the Firm ever distribute any other written instructions, guidelines, policies, or procedures relating to the use or supervision of Non-Traditional ETFs? If so, provide copies of all relevant documentation.
4. During the Relevant Period, did the Firm have a system in place for monitoring transactions in Non-Traditional ETFs? If so, provide a detailed narrative describing the system.
5. Provide a list of all exception reports available to any Firm Personnel during the Relevant Period related to Non-Traditional ETFs. For each report provide:
    a. name/title of reports;
    b. the frequency that reports are generated;
    c. name, CRD number and job title of all individuals responsible for reviewing the reports; and
    d. any guidance, written instructions, policies, or procedures relating to this report.
6. Has the Firm ever provided training specific to Non-Traditional ETFs? If so, provide dates of training, names and CRD numbers of those individuals conducting the training, a list of names and CRD number of those attending the training, and copies of all documentation during the training.
7. Provide a detailed narrative describing how the Firm vets new products. This narrative should identify all departments, committees and persons involved in the determination to approve new products for sale.
8. Provide a list of all Non-Traditional ETFs approved for sale by the Firm during the Relevant Period.
9. Provide a detailed narrative describing the process for approving the use of Non-Traditional ETFs. This narrative should identify all departments, committees and persons involved in the process and should state when Non-Traditional ETFs were approved for sale by the Firm's agents.

10. Provide any and all documentation reflecting or arising from the vetting of Non-Traditional ETFs, including but not limited to changes to the Firm's WSPs and product specific training material.
11. Provide examples of all exception or surveillance reports the Firm utilized during the Relevant Period that served as a compliance and/or suitability monitoring aid to the Firms management in connection with the supervision of Non-Traditional ETFs.
12. Provide a copy of each organizational chart in effect during the Relevant Period for the department(s) responsible for compliance and/or supervision of retail operations and transactions in effect during the Relevant Period. Please include names, CRD numbers, and job titles for each individual, as well as the dates in which the organization chart was in effect.
13. Identify each person who had a responsibility to supervise **NAME OF AGENT** (the "Identified Agent"). Include in your response the following information for each supervisor identified:
    a. A description of his or her specific supervisory obligations with respect to the Identified Agent;
    b. A description of his or her education, work experience, or other qualifications considered by the Firm before such person was given supervisory obligations with respect to the Identified Agent; and
    c. The name, CRD number, and business location of persons who supervised the activities of the supervisor during the Relevant Period.
14. Provide any and all correspondence between the Identified Agent any individual supervising the Identified Agent regarding Non-Traditional ETFs.
15. Provide any and all correspondence referencing Non-Traditional ETFs between any Firm customer and the Firm or the Identified Agent during the Relevant Period.
16. Provide copies of all investor complaints and arbitration/litigation claims concerning Non-Traditional ETFs submitted during the Relevant Period. Additionally, provide copies of the Firm's responses.
17. Provide a list of all accounts owned by or held for the benefit of current Kansas residents, whether open or closed, which at any point during the Relevant Period held Non-Traditional ETFs. Similarly, provide a list of all accounts owned by or held for the benefit of clients that were Kansas residents at the time that Non-Traditional ETFs were held in said accounts.
18. Provide a list of all current or former Kansas clients who at any time during the Relevant Period held Non-Traditional ETFs.

**BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF KANSAS**

In the Matter of:

GARTNER FINANCIAL GROUP, LLC (CRD #148539),
and
SCOTT ALAN GARTNER (CRD #1718453),

Respondents.

Docket No. 14 E 001
KSC No. 2013-6110

Pursuant to K.S.A. 17-12a412

EMERGENCY ORDER OF SUSPENSION
and
NOTICE OF INTENT TO IMPOSE ADMINISTRATIVE SANCTIONS

COMES NOW the above-entitled matter for consideration by the Securities Commissioner of Kansas. Upon due deliberation, the Commissioner finds as follows:

Findings of Fact

JURISDICTION

1. Pursuant to K.S.A. 17-12a601, the Securities Commissioner of Kansas is charged with administering the Kansas Uniform Securities Act.

2. Pursuant to K.S.A. 17-12a412, found in the Kansas Uniform Securities Act, an order may be issued to revoke, suspend, condition the registration of, or penalize a person or entity that is registered with the Office of the Kansas Securities Commissioner as a broker-dealer, agent of a broker-dealer, investment adviser, or investment adviser representative.

3. At the time when the actions relevant to this matter occurred, Respondent Gartner Financial Group, LLC (Gartner Financial) was, and currently is, registered with the Office of the Kansas Securities Commissioner as an investment adviser.

4. At the time when the actions relevant to this matter occurred, Respondent Scott Alan Gartner (Gartner) was, and currently is, registered with the Office of the Kansas Securities Commissioner as an investment adviser representative.

5. Accordingly, the Kansas Securities Commissioner has jurisdiction over this matter.

RELEVANT TIME PERIOD

6. All actions and transactions relevant to this matter occurred between March 1, 2013 and July 25, 2013.

RESPONDENTS

7. At the time when the actions relevant to this matter occurred, Respondent Gartner Financial was a limited liability company organized under the laws of the State of Kansas and had a registered address of

8. Currently, Respondent Gartner Financial is in forfeited status with the Kansas Secretary of State's Office.

9. Respondent Gartner Financial has a current business address of

10. Respondent Gartner is an individual with a current business and residential address of

11. Respondent Gartner is the direct owner, president, chief executive officer, and chief compliance officer of Respondent Gartner Financial.

IMPEDING AN AUDIT OR INSPECTION

12. Pursuant to K.S.A. 17-12a412(d)(8), the Securities Commissioner of Kansas may discipline a person registered as an investment adviser or investment adviser representative for

impeding an audit or inspection and/or willfully failing to comply with a request for information by the Securities Commissioner or person designated by the Securities Commissioner in conducting investigations or audits.

13. On May 14, 2013, the Office of the Kansas Securities Commissioner mailed Respondents a letter notifying them that the Office of the Kansas Securities Commissioner had scheduled a compliance inspection for Respondent Gartner Financial.

14. The May 14, 2013, letter contained 22 specific requests for information and documents that Respondents were to provide to the Office of the Kansas Securities Commissioner.

15. The May 14, 2013, letter specified that the requested documents and information were to be delivered to the Office of the Kansas Securities Commissioner no later than May 24, 2013.

16. Respondents did not deliver the documents and information that were requested by the May 14, 2013, letter on or before May 24, 2013.

17. On June 4, 2013, the Office of the Securities Kansas Commissioner sent an email to Respondents informing them that they had not responded to the May 14, 2013, letter. A copy of the May 14, 2013, letter was attached to the email.

18. Respondents did not respond to the June 4, 2013, email.

19. On July 10, 2013, a representative from the Office of the Kansas Securities Commissioner drove to Respondents' address and personally handed Respondent Gartner a copy of the May 14, 2013, letter.

20. On July 10, 2013, the Office of the Kansas Securities Commissioner sent Respondents, via U.S. mail and email, a follow-up letter informing Respondents that their

response to the May 14, 2013, letter must be delivered to the Office of the Kansas Securities Commissioner on or before July 12, 2013.

21. On July 12, 2013, Respondent Gartner contacted the Office of the Kansas Securities Commissioner via telephone and stated that he intended to cease conducting business as an investment adviser representative for lack of activity and withdraw the registration of Respondent Gartner Financial as an investment adviser rather than provide the requested information to the Office of the Kansas Securities Commissioner.

22. During the July 12, 2013, telephone conversation, Respondent Gartner agreed to appear at the Topeka office of the Office of the Kansas Securities Commissioner at 1:30 p.m. on July 18, 2013. Additionally, Respondent Gartner was instructed to bring all documents and information requested by the May 14, 2013, letter.

23. Respondent Gartner appeared at the Topeka office of the Office of the Kansas Securities Commissioner at approximately 1:40 p.m. on July 18, 2013.

24. On July 18, 2013, Respondent Gartner did not bring, to the Topeka office of the Office of the Kansas Securities Commissioner, any of the documents and information requested by the May 14, 2013, letter.

25. At the conclusion of the July, 18, 2013, interview, Respondent Gartner was given a list of documents that he had agreed to provide during the course of the interview.

26. Respondent Gartner agreed to deliver the documents requested on the list referenced in Paragraph 25, above, on or before Tuesday July 23, 2013.

27. Respondent Gartner did not deliver the documents requested on the list referenced in Paragraph 25, above, on or before Tuesday July 23, 2013.

28. As of the date of this order, Respondents have not provided any of the information or documents requested by the Office of the Kansas Securities Commissioner pursuant to the May 24, 2013, request letter.

29. As of the date of this order, Respondents have not provided any of the documents requested on the list referenced in Paragraph 25, above.

30. During the July 18, 2013, interview, Respondent Gartner disclosed to representatives from the Office of the Kansas Securities Commissioner that he had invested $10,000 of his own money in a 1913 gold-backed Chinese government bond (Chinese bond).

31. During the July 18, 2013, interview, Respondent Gartner stated that he had not invested any other person's monies in the Chinese bond.

32. Despite Respondent Gartner's assertions to representatives from the Office of the Kansas Securities Commissioner that he had not invested any other person's monies in the Chinese bond, on March 27, 2013, Respondent Gartner visited William H. Norman (Norman) at Norman's home in Ozawkie, Kansas.

33. During the March 27, 2013, visit, Respondent Gartner claimed he had a good deal that would double Norman's investment in 90 days.

34. During the March 27, 2013, visit, Norman gave Respondent Gartner a check for $10,000 made payable to Respondent Gartner personally.

35. Respondent Gartner used the $10,000 that he received from Norman to purchase an interest in the Chinese bond described in Paragraph 30, above.

36. Respondent Gartner supplied false information to representatives of the Office of the Kansas Securities Commissioner when he stated that he did not invest monies from any other person in the Chinese bond.

Conclusions of Law

1. The Securities Commissioner of Kansas has jurisdiction over this matter pursuant to K.S.A. 17-12a412.

2. Respondents have impeded staff for Office of the Kansas Securities Commissioner from conducting an audit or inspection, in violation of K.S.A. 17-12a412(d)(8).

3. Respondents, willfully and without cause, failed to comply with requests for information made by staff for the Office of the Kansas Securities Commissioner, in violation of K.S.A. 17-12a412(d)(8).

4. By impeding an audit or inspection and failing to comply with requests for information made by staff for the Office of the Kansas Securities Commissioner, Respondents have prevented the Office of the Kansas Securities Commissioner from carrying out its statutory duty to administer the Kansas Uniform Securities Act and have thus created an immediate danger to Kansas investors.

5. Pursuant to K.S.A. 17-12a412(f) and K.S.A. 77-536, an emergency order of suspension is necessary in this matter to prevent harm to the public.

IT IS THEREFORE ORDERED by the Securities Commissioner that:

1. Respondent Gartner Financial Group, LLC is immediately suspended from conducting business as an investment adviser in the state of Kansas.

2. Respondent Scott Alan Gartner is immediately suspend from conducting business as an investment adviser representative in the state of Kansas.

3. The suspensions ordered herein shall remain in effect until this order is modified or vacated by further proceedings held in this matter.

FURTHERMORE, the Securities Commissioner hereby notifies the Respondents that he intends to impose, based upon the above Findings of Fact and Conclusions of Law, the following administrative sanctions:

1. A civil penalty of no more than $25,000 against Respondent Gartner Financial Group, LLC,

2. Revocation of the registration of Respondent Gartner Financial Group, LLC as an investment adviser in the state of Kansas,

3. A civil penalty of no more than $25,000 against Respondent Scott Alan Gartner, and

4. Revocation of the registration of Respondent Scott Alan Gartner as an investment adviser representative in the state of Kansas.

Opportunity for Hearing

If the Respondents wish to contest the Findings of Fact and Conclusions of Law set forth herein, the Respondents must file a request for hearing within thirty (30) days after service of this Order. The request for hearing must be in the manner and form prescribed by K.A.R. 81-11-5, and it must be filed with the Office of the Kansas Securities Commissioner, 109 SW 9th Street, Suite 600, Topeka, Kansas 66612. The request for hearing must be verified under oath by the Respondents and, if the Respondents dispute any of the Findings of Fact or Conclusions of Law set forth herein, the Respondents shall specifically deny such findings/conclusions or they will be deemed admitted. In addition, the Respondents may offer evidence and argument to mitigate the findings/conclusions set forth herein. If the findings/conclusions are properly disputed, a hearing officer will be appointed and the matter will be set for hearing. If no request for hearing is filed within thirty (30) days after service of this Order, this Order will be modified to include the above enumerated sanctions and will become final by operation of law.

IT IS SO ORDERED BY THE COMMISSIONER.

Entered at Topeka, Kansas, this 30th day of July, 2013.

Joshua A. Ney
Acting Securities Commissioner
State of Kansas

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U.S. Securities and Exchange Commission

Information for Newly-Registered Investment Advisers

Prepared by the Staff of the Securities and Exchange Commission's Division of Investment Management and Office of Compliance Inspections and Examinations[1]

This information sheet contains general information about certain provisions of the Investment Advisers Act of 1940 (also called the "Advisers Act") and selected rules under the Advisers Act. It is intended to assist newly-registered investment advisers in understanding their compliance obligations with respect to these provisions. This information sheet also provides information about the resources available to investment advisers from the SEC to help advisers understand and comply with these laws and rules.

As an adviser registered with the SEC, you have an obligation to comply with all of the applicable provisions of the Advisers Act and the rules that have been adopted by the SEC. This information sheet does not provide a complete description of all of the obligations of SEC-registered advisers under the law. To access the Advisers Act and rules and other information, visit the SEC's website at www.sec.gov (the Advisers Act and rules are available at http://www.sec.gov/divisions/investment.shtml).[2]

Investment Advisers Are Fiduciaries

As an investment adviser, you are a "fiduciary" to your advisory clients. This means that you have a fundamental obligation to act in the best interests of your clients and to provide investment advice in your clients' best interests. You owe your clients a duty of undivided loyalty and utmost good faith. You should not engage in any activity in conflict with the interest of any client, and you should take steps reasonably necessary to fulfill your obligations. You must employ reasonable care to avoid misleading clients and you must provide full and fair disclosure of all material facts to your clients and prospective clients. Generally, facts are "material" if a reasonable investor would consider them to be important. You must eliminate, or at least disclose, all conflicts of interest that might incline you — consciously or unconsciously — to render advice that is not disinterested. If you do not avoid a conflict of interest that could impact the impartiality of your advice, you must make full and frank disclosure of the conflict. You cannot use your clients' assets for your own benefit or the benefit of other clients, at least without client consent. Departure from this fiduciary standard may constitute "fraud" upon your clients (under Section 206 of the Advisers Act).

Investment Advisers Must Have Compliance Programs

As a registered investment adviser, you are required to adopt and implement written policies and procedures that are reasonably designed to prevent violations of the Advisers Act. The Commission has said that it expects that these policies and procedures would be designed to prevent, detect, and correct violations of the Advisers Act. You must review those policies and procedures at least annually for their adequacy and the effectiveness of their implementation, and designate a chief compliance officer ("CCO") to be responsible for administering your policies and procedures (under the "Compliance Rule" — Rule 206(4)-7).

We note that your policies and procedures are not required to contain specific elements. Rather, you should analyze your individual operations and identify conflicts and other compliance factors that create risks for your firm and then design policies and procedures that address those risks. The Commission has stated that it expects your policies and procedures, at a minimum, to address the following issues to the extent that they are relevant to your business:

- *Portfolio management* processes, including allocation of investment opportunities among clients and consistency of portfolios with clients' investment objectives, your disclosures to clients, and applicable regulatory restrictions;
- The *accuracy of disclosures* made to investors, clients, and regulators, including account statements and advertisements;
- *Proprietary trading* by you and the personal trading activities of your supervised persons;
- *Safeguarding of client assets* from conversion or inappropriate use by your personnel;
- The accurate creation of *required records* and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction;
- Safeguards for the *privacy protection* of client records and information;
- *Trading practices*, including procedures by which you satisfy your best execution obligation, use client brokerage to obtain research and other services (referred to as "soft dollar arrangements"), and allocate aggregated trades among clients;
- *Marketing* advisory services, including the use of solicitors;
- Processes to *value client holdings* and *assess fees* based on those valuations; and
- *Business continuity* plans.

Investment Advisers Are Required to Prepare Certain Reports and to File Certain Reports with the SEC

As a registered investment adviser, you are required to file an annual update of Part 1A of your registration form (Form ADV) through the *Investment Advisers Registration Depository* (IARD). You must file an annual updating amendment to your Form ADV within 90 days after the end of your fiscal year. In addition to making annual filings, you must *promptly* file an amendment to your Form ADV whenever certain information contained in your Form ADV becomes inaccurate (the Form ADV filing requirements are contained in Rule 204-1 of the Advisers Act, and in the instructions to the Form).

- Make sure your Form ADV is complete and current. Inaccurate, misleading, or omitted Form ADV disclosure is the most frequently cited finding from our examinations of investment advisers.
- Please keep the e-mail address of your contact person current (Form ADV, Part 1A, Item 1J). We use this e-mail address to keep you apprised of important developments (including when it's time to file an amendment to your Form ADV).

- Accurately report the amount of assets that you have under management (Form ADV, Part 1A, Item 5F(2)). Advisers who have less than $25 million of assets under management, who are not otherwise eligible to maintain their registration with the SEC, or who stop doing business as an investment adviser, should file a Form ADV-W through IARD to withdraw their registration.

With respect to Part 2A of your Form ADV, you are required to file it electronically through IARD. As with Part 1A, you must update Part 2 annually within 90 days of the end of your fiscal year and whenever it becomes materially inaccurate. Part 2B brochure supplements, are not required to be uploaded to IARD.

You may also be subject to other reporting obligations. For example, an adviser that exercises investment discretion (or that shares investment discretion with others) over certain equity securities (including convertible debt and options), which have a fair market value in the aggregate of $100 million or more, must file a Form 13F each quarter that discloses these holdings. "Discretionary authority" means that you have the authority to decide which securities to purchase, sell, and/or retain for your clients.

You should also be aware that it is unlawful to make any untrue statement or omit any material facts in an application or a report filed with the SEC (under Section 207 of the Advisers Act), including in Form ADV and Form ADV-W.

Investment Advisers Must Provide Clients and Prospective Clients with a Written Disclosure Statement

Registered investment advisers are required to provide their advisory clients and prospective clients with a written disclosure document (these requirements, and a few exceptions, are set forth in Rule 204-3 under the Advisers Act). As a registered adviser, you comply with this requirement by providing advisory clients and prospective clients with Part 2 of your Form ADV. This written disclosure document should be delivered to your prospective clients before or at the time of entering into an advisory contract (under certain conditions, you may comply with the delivery requirements through electronic media).

Each year, you also need to deliver Part 2 or summary of material changes to each client, without charge. You are required to maintain a copy of each disclosure document and each amendment or revision to it that was given or sent to clients or prospective clients, along with a record reflecting the dates on which such disclosure was given or offered to be given to any client or prospective client who subsequently became a client (under Rule 204-2(a)(14)).

Investment Advisers Must Have a Code of Ethics Governing Their Employees and Enforce Certain Insider Trading Procedures

As a registered investment adviser, you are required to adopt a code of ethics (under the "Code of Ethics Rule" — Rule 204A-1 under the Advisers Act). Your code of ethics should set forth the standards of business conduct expected of your "supervised persons" (*i.e.*, your employees, officers, directors and other people that you are required to supervise), and it must address personal securities trading by these people.

We note that you are not required to adopt a particular standard of business ethics. Rather, the standard that you choose should reflect your fiduciary obligations to your advisory clients and the fiduciary obligations of the people you supervise, and require compliance with the federal securities laws. In adopting a code of ethics, investment advisers may set higher ethical standards than the requirements under the law.

In order to prevent unlawful trading and promote ethical conduct by advisory employees, advisers' codes of ethics should include certain provisions relating to personal securities trading by advisory personnel. Your code of ethics must include the following requirements:

- Your "access persons" must report their personal securities transactions to your CCO or to another designated person each quarter. "Access persons" are any of your supervised persons who have access to non-public information regarding client transactions or holdings, make securities recommendations to clients or have access to such recommendations, and, for most advisers, all officers, directors and partners.

- Your access persons must submit a complete report of the securities that they hold at the time they first become an access person, and then at least once each year after that.[3] Your code of ethics must also require that your access persons obtain your approval prior to investing in initial public offerings or private placements or other limited offerings, including pooled investment vehicles (except if your firm has only one access person).

- Your CCO or another person you designate in addition to your CCO must review these personal securities transaction reports.

- Your supervised persons must promptly report violations of your code of ethics (*i.e.*, including the federal securities laws) to the CCO or to another person you designate (provided your CCO also receives a report on such issues). You must also maintain a record of these breaches.

Also, as a registered investment adviser, you are required to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the misuse of material non-public information (under Section 204A of the Advisers Act). These policies and procedures must encompass your activities and those of your supervised persons. Advisers often include this prohibition on insider trading in their code of ethics.

Provide each of the people that you supervise with a copy of your code of ethics (and any amendments that you subsequently make to it), and also obtain a written acknowledgement from the supervised person that he/she has received it. In addition, you must describe your code of ethics in your Form ADV, Part 2, Item 11 and provide a copy to your advisory clients, if they request it.

Investment Advisers are Required to Maintain Certain Books and Records

As a registered adviser, you must make and keep true, accurate and current certain books and records relating to your investment advisory business (under "the Books and Records Rule" — Rule 204-2). The books and records that you must make and keep are quite specific, and are described below in part:

- Advisory business financial and accounting records, including: cash receipts and disbursements journals; income and expense account ledgers; checkbooks; bank account statements; advisory business bills; and financial statements.
- Records that pertain to providing investment advice and transactions in client accounts with respect to such advice, including: orders to trade in client accounts (referred to as "order memoranda"); trade confirmation statements received from broker-dealers; documentation of proxy vote decisions; written requests for withdrawals or documentation of deposits received from clients; and written correspondence you sent to or received from clients or potential clients discussing your recommendations or suggestions.

- Records that document your authority to conduct business in client accounts, including: a list of accounts in which you have discretionary authority; documentation granting you discretionary authority; and written agreements with clients, such as advisory contracts.
- Advertising and performance records, including: newsletters; articles; and computational worksheets demonstrating performance returns.
- Records related to the Code of Ethics Rule, including those addressing personal securities transaction reporting by access persons.
- Records regarding the maintenance and delivery of your written disclosure document and disclosure documents provided by certain solicitors who seek clients on your behalf.
- Policies and procedures adopted and implemented under the Compliance Rule, including any documentation prepared in the course of your annual review.

Some advisers are required to maintain additional records. For example, advisers that have custody and possession of clients' funds and/or securities must make and keep additional records that are described in the Books and Records Rule (Rule 204-2, paragraph (b)), and advisers who provide investment supervisory or management services to any client must also make and keep specific additional records (which are described in Rule 204-2, paragraph (c)).

You must keep these records for specified periods of time. Generally, most books and records must be kept for five years from the last day of the fiscal year in which the last entry was made on the document or the document was disseminated. You may be required to keep certain records for longer periods, such as records that support performance calculations used in advertisements (as described in Rule 204-2, paragraph (e)).

You are required to keep your records in an easily accessible location. In addition, for the first two of these years, you must keep your records in your office(s). If you maintain some of your original books and records somewhere other than your principal office and place of business, you must note this practice and identify the alternative location on your Form ADV (in Section 1K of Schedule D). Many advisers store duplicate copies of their advisory records in a location separate from their principal office in order to ensure the continuity of their business in the case of a disaster.

You may store your original books and records by using either micrographic media or electronic media. These media generally include microfilm or digital formats (*e.g.*, electronic text, digital images, proprietary and off-the-shelf software, and email). If you use email or instant messaging to make and keep the records that are required under the Advisers Act, you should keep the email, including all attachments that are required records, as examiners may request a copy of the complete record. In dealing with electronic records, you must also take precautions to ensure that they are secure from unauthorized access and theft or unintended destruction (similar safeguarding provisions regarding client information obtained by you is required by Regulation S-P under the Gramm-Leach-Bliley Act). In general, you should be able to promptly (generally within 24 hours) produce required electronic records that may be requested by the SEC staff, including email. In order to do so, the Advisers Act requires that you arrange and index required electronic records in a way that permits easy location, access, and retrieval of any particular electronic record.

Investment Advisers Must Seek to Obtain the Best Price and Execution for Their Clients' Securities Transactions

As a fiduciary, you are required to act in the best interests of your advisory clients, and to seek to obtain the best price and execution for their securities transactions. The term "best execution" means seeking the best price for a security in the marketplace as well as ensuring that, in executing client transactions, clients do not incur unnecessary brokerage costs and charges. You are not obligated to get the lowest possible commission cost, but rather, you should determine whether the transaction represents the best qualitative execution for your clients. In addition, whenever trading may create a conflicting interest between you and your clients, you have an obligation, before engaging in the activity, to obtain the informed consent from your clients after providing full and fair disclosure of all material facts. The Commission has described the requirement for advisers to seek best execution in various situations.

In selecting a broker-dealer, you should consider the full range and quality of the services offered by the broker-dealer, including the value of the research provided, the execution capability, the commission rate charged, the broker-dealer's financial responsibility, and its responsiveness to you. To seek to ensure that you are obtaining the best execution for your clients' securities trades, you must periodically evaluate the execution performance of the broker-dealers you use to execute clients' transactions.

You may determine that it is reasonable for your clients to pay commission rates that are higher than the lowest commission rate available in order to obtain certain products or services from a broker-dealer (*i.e.*, soft dollar arrangement). To qualify for a "safe harbor" from possible charges that you have breached your fiduciary duty by causing your clients to pay more than the lowest commission rate, you must use clients' brokerage commissions to pay for certain defined "brokerage or research" products and services, use such products and services in making investment decisions, make a good faith determination that the commissions that clients will pay are reasonable in relation to the value of the products and services received, and disclose these arrangements.

The SEC staff has stated that, in directing orders for the purchase or sale of securities, you may aggregate or "bunch" orders on behalf of two or more client accounts, so long as the bunching is done for the purpose of achieving best execution, and no client is systematically advantaged or disadvantaged by the bunching. The SEC staff has also said that, if you decide not to aggregate orders for client accounts, you should disclose to your clients that you will not aggregate and the potential consequences of not aggregating orders.

If your clients impose limitations on how you will execute securities transactions on their behalf, such as by directing you to exclusively use a specific broker-dealer to execute their securities transactions, you have an obligation to fully disclose the effects of these limitations to the client. For example, if you negotiate volume commission discounts on bunched orders, a client that has directed you to use a specific broker should be informed that he/she will forego any benefit from savings on execution costs that you might obtain for your other clients through this practice.

You should also seek to obtain the best price and execution when you enter into transactions for clients on a "principal" or "agency cross" basis. If you have acted as a principal for your own account by buying securities from, or selling securities to, a client, you must disclose the arrangement and the conflicts of interest in this practice (in writing) and also obtain the client's consent for *each* transaction prior to the time that the trade settles. There are also explicit conditions under which you may cross your advisory clients' transactions in securities with securities transactions of others on an agency basis (under Rule 206(3)-2). For example, you must obtain advance written authorization from the client to execute such transactions, and also provide clients with specific written disclosures. Compliance with Rule 206(3)-2 is generally not required for transactions internally crossed or effected between two or more clients you advise and for which you receive no additional compensation (*i.e.*, commissions or transaction-based compensation); however, full disclosure regarding this practice should be made to your clients.

Requirements for Investment Advisers' Contracts with Clients

As a registered investment adviser, your contracts with your advisory clients must include some specific provisions (which are set forth in Section 205 of the Advisers Act). Your advisory contracts (whether oral or written) must convey that the advisory services that you provide to the client may not be assigned by you to any other person without the prior consent of the client. With limited exceptions, contracts cannot include provisions providing for your compensation to be based on the performance of the client's account. In addition, the SEC staff has stated that an adviser should not enter into contracts with clients, except with certain sophisticated clients, that contain terms or clauses commonly referred to as a "hedge clause" because such clauses or provisions are likely to lead other clients to believe that they have waived their rights of legal action, whether under the federal securities laws or common law.

Investment Advisers May be Examined by the SEC Staff

As a registered investment adviser, your books and records are subject to compliance examinations by the SEC staff (under Section 204 of the Advisers Act). The purpose of SEC examinations is to protect investors by determining whether registered firms are complying with the law, adhering to the disclosures that they have provided to their clients, and maintaining appropriate compliance programs to ensure compliance with the law. If you are examined, you are required to provide examiners with access to all requested advisory records that you maintain (under certain conditions, documents may remain private under the attorney-client privilege).

More information about examinations by the SEC and the examination process is provided in the brochure, "*Examination Information for Broker-Dealers, Transfer Agents, Clearing Agencies, Investment Advisers and Investment Companies*," which is available on the SEC's website at http://www.sec.gov/about/offices/ocie/ocie_exambrochure.pdf.

Requirements for Investment Advisers that Vote Proxies of Clients' Securities

As a registered investment adviser, if you have voting authority over proxies for clients' securities, you must adopt policies and procedures reasonably designed to ensure that you: vote proxies in the best interests of clients; disclose information to clients about those policies and procedures; and describe to clients how they may obtain information about how you have voted their proxies (these requirements are in Rule 206(4)-6 under the Advisers Act).

If you vote proxies on behalf of your clients, you must also retain certain records. You must keep: your proxy voting policies and procedures; the proxy statements you received regarding your client's securities (the Rule provides some alternative arrangements); records of the votes you cast on behalf of your clients; records of client requests for proxy voting information; and any documents that you prepared that were material to making a decision as to how to vote or that memorialized the basis for your decision (these requirements are described in Advisers Act Rule 204-2(c)(2)).

Requirements for Investment Advisers that Advertise their Services

To protect investors, the SEC prohibits certain types of advertising practices by advisers. An "advertisement" includes any communication addressed to more than one person that offers any investment advisory service with regard to securities (under “the Advertising Rule” — Rule 206(4)-1). An advertisement could include both a written publication (such as a website, newsletter or marketing brochure) as well as oral communications (such as an announcement made on radio or television).

Advertising must not be false or misleading and must not contain any untrue statement of a material fact. Advertising, like all statements made to advisory clients and prospective clients, is subject to the general prohibition on fraud (Section 206 as well as other anti-fraud provisions under the federal securities laws). Specifically prohibited are: testimonials; the use of past specific recommendations that were profitable, unless the adviser includes a list of all recommendations made during the past year; a representation that any graph, chart, or formula can in and of itself be used to determine which securities to buy or sell; and advertisements stating that any report, analysis, or service is free, unless it really is free.

The SEC staff has said that, if you advertise your past investment performance record, you should disclose all material facts necessary to avoid any unwarranted inference. For example, SEC staff has indicated that it may view performance data to be misleading if it:

- does not disclose prominently that the results portrayed relate only to a select group of the adviser’s clients, the basis on which the selection was made, and the effect of this practice on the results portrayed, if material;
- does not disclose the effect of material market or economic conditions on the results portrayed (e.g., an advertisement stating that the accounts of the adviser’s clients appreciated in value 25% without disclosing that the market generally appreciated 40% during the same period);
- does not reflect the deduction of advisory fees, brokerage or other commissions, and any other expenses that accounts would have or actually paid;
- does not disclose whether and to what extent the results portrayed reflect the reinvestment of dividends and other earnings;
- suggests or makes claims about the potential for profit without also disclosing the possibility of loss;
- compares model or actual results to an index without disclosing all material facts relevant to the comparison (e.g., an advertisement that compares model results to an index without disclosing that the volatility of the index is materially different from that of the model portfolio); and
- does not disclose any material conditions, objectives, or investment strategies used to obtain the results portrayed (e.g., the model portfolio contains equity stocks that are managed with a view towards capital appreciation).

In addition, as a registered adviser, you may not imply that the SEC or another agency has sponsored, recommended or approved you, based upon your registration (under Section 208 of the Advisers Act). You should not use the term “registered investment adviser” unless you are registered, and you should not use this term to imply that as a registered adviser, you have a level of professional competence, education or special training. For example, the SEC staff has stated that advisers should not use the term “RIA” after a person’s name because using initials after a name usually indicates a degree or a licensed professional position for which there are certain qualifications; however, there are no federal qualifications for becoming an SEC-registered adviser.

Requirements for Investment Advisers that Pay Others to Solicit New Clients

Registered investment advisers may pay cash compensation to others to seek out new clients on their behalf, commonly called "solicitors" or "finders," if they meet certain conditions (under Rule 206(4)-3 of the Advisers Act):

- The solicitor is not subject to certain disciplinary actions.
- The fee is paid pursuant to a written agreement to which you are a party and (with limited exceptions) the agreement must: describe the solicitor's activities and compensation arrangement; require that the solicitor perform the duties you assign and in compliance with the Advisers Act; require the solicitor to provide clients with a current copy of your disclosure document; and, if seeking clients for personalized advisory services, require the solicitor to provide clients with a separate written disclosure document containing specific information.
- You receive from the solicited client, prior to or at the time you enter into an agreement, a signed and dated notice confirming that he/she was provided with your disclosure document and, if required, the solicitor's disclosure document.
- You have a reasonable basis for believing that the solicitor has complied with the terms of your agreement.

Requirements for Investment Advisers that have Custody or Possession of Clients' Funds or Securities

Registered investment advisers that have "custody" or "possession" of client assets must take specific measures to protect client assets from loss or theft (under "the Custody Rule" — Rule 206(4)-2 under the Advisers Act).

The first step is to determine whether you have custody or possession of client assets. "Custody" is defined as "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them." This includes situations in which you:

- have physical possession of client funds or securities, even temporarily;
- enter into arrangements (including a general power of attorney) authorizing you to withdraw funds or securities from the client's account (note that if you are authorized to deduct your advisory fees or other expenses directly from clients' accounts, you have custody); and
- serve in a capacity that gives you or a supervised person legal ownership or access to client funds or securities (note that if you are a general partner to a privately-offered pooled investment vehicle, you have custody).
- If you are a trustee, you may have custody.

If you have custody, with limited exceptions, you must maintain these client funds and securities at a "qualified custodian." Generally, qualified custodians include most banks and insured savings associations, SEC-registered broker-dealers, Commodity Exchange Act-registered futures commission merchants, and certain foreign financial institutions. With a limited exception, for client accounts over which you have custody, you must have a reasonable basis, after due inquiry, for believing that the client (or a designated representative) receives periodic reports *directly from the custodian* that contain specific information with respect to the funds and securities in custody. With respect to pooled investment vehicles over which you have custody, the qualified custodian must send account statements for the pooled vehicle directly to each investor.

If you have custody of client funds or securities that are held at an unrelated, independent qualified custodian, then you must have a "surprise verification" by an independent public accountant. The independent public accountant must verify the funds and securities in your custody or possession at least once each calendar year, and must then promptly file a "certificate of accounting" with Form ADV-E electronically through IARD.[4]

If you have custody of client funds or securities that you or a related person maintains as a qualified custodian, then you must also have an internal control report completed by an independent public accountant registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board.

Staff answers to frequently asked questions regarding the custody rule may be found at http://www.sec.gov/divisions/investment/custody_faq_030510.htm.

Requirements for Investment Advisers to Disclose Certain Financial and Disciplinary Information

Registered investment advisers may be required to disclose certain financial and disciplinary information (under Rule 206(4)-4 under the Advisers Act). These requirements are described below.

Registered advisers that have custody or discretionary authority over client funds or securities, or that require prepayment six months or more in advance of more than $1,200 in advisory fees, must promptly disclose to clients and any prospective clients any financial conditions that are reasonably likely to impair their ability to meet their contractual commitments to their clients.

All registered advisers must also promptly disclose any legal or disciplinary events that would be material to a client's or a prospective client's evaluation of the adviser's integrity or its ability to meet its commitments to clients (regardless of whether the adviser has custody or requires prepayment of fees). The types of legal and disciplinary events that may be material include:

- Criminal or civil actions, where the adviser or a management person of the adviser was convicted, pleaded guilty or "no contest," or was subject to certain disciplinary actions with respect to conduct involving investment-related businesses, statutes, regulations, or activities; fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion.

- Administrative proceedings before the SEC, other federal regulatory agencies, or any state agency where the adviser's or a management person's activities were found to have caused an investment-related business to lose its authorization to do business or where such person was involved in a violation of an investment-related statute or regulation and was the subject of specific disciplinary actions taken by the agency.

- Self-regulatory organization (SRO) proceedings in which the adviser or a management person was found to have caused an investment-related business to lose its authorization to do business; or was found to have been involved in a violation of the SRO's rules and was the subject of specific disciplinary actions taken by the organization.

Informational Resources Available From the SEC

The SEC provides a great deal of helpful information about the compliance obligations of investment advisers on the SEC's website at http://www.sec.gov/divisions/investment.shtml. This information includes links to relevant laws and rules, staff guidance and studies, enforcement cases, and staff no-action and interpretive letters (generally from 2001 — present). In addition, the SEC's website contains a list of the source materials that were used in preparing this information sheet.

To assist chief compliance officers of investment advisers and investment companies in meeting their compliance responsibilities and to help enhance compliance in the securities industry, the SEC has established the "*CCOutreach Program.*" This program includes regional and national seminars on compliance issues of concern to CCOs. Information about *CCOutreach* and any scheduled events is available at http://www.sec.gov/info/ccoutreach.htm.

Finally, the SEC staff regularly receive calls and correspondence concerning the application of the federal securities laws, and advisers and other registrants are encouraged to communicate any questions or issues to SEC staff. To ensure that you reach the right person at the SEC, the SEC's website lists the names and contact information for SEC staff in the Division of Investment Management who are responsible for responding to communication from the public about specific topics (http://www.sec.gov/divisions/investment/imcontact.htm). With respect to issues or questions that arise in the context of a compliance examination by the SEC, advisers are encouraged to raise any questions or issues directly with the SEC examination team, or with examination supervisors in their local SEC office (contact information for senior examination staff is available at http://www.sec.gov/about/offices/ocie/ocie_org.htm).

Additional Information: Reference Materials

The following informational sources may be helpful.

Investment Advisers Are Fiduciaries

- Section 206 of the Advisers Act.
- *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), available on the SEC's website at http://www.sec.gov/about/offices/ocie/iainfo/capitalgains1963.pdf.
- *In re Arleen W. Hughes*, Release No. 34-4048 (Feb 18, 1948), available on the SEC's website at http://www.sec.gov/litigation/opinions/2007/ia-4048.pdf.

Investment Advisers Must Have Compliance Programs

- Rule 206(4)-7 under the Advisers Act.
- *Compliance Programs of Investment Companies and Investment Advisers*, Advisers Act Release No. 2204 (Dec. 17, 2003), available on the SEC's website at http://www.sec.gov/rules/final/ia-2204.htm.

Investment Advisers Are Required to Prepare Certain Reports and to File Certain Reports with the SEC

- Form ADV (Part 1A and Part 2), instructions to the Form, and filing requirements contained Rule 204-1 under the Advisers Act.
- A list of the amendments that advisers must make to their Form ADV is in the *General Instructions to Form ADV* (Item 4) at http://www.sec.gov/pdf/fadvpo.pdf.

- SEC staff's responses to frequently asked questions regarding completing and filing Form ADV are available on the SEC's website at http://www.sec.gov/divisions/investment/iard/iardfaq.shtml.
- Additional information regarding Form 13F and an official list of securities that fall under Section 13(f) of the Securities Exchange Act are on the SEC's website at http://www.sec.gov/answers/form13f.htm.

Investment Advisers Must Provide Clients and Prospective Clients with a Written Disclosure Statement

- Rule 204-3 under the Advisers Act.
- *Use Of Electronic Media By Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under The Securities Act Of 1933, Securities Exchange Act Of 1934, And Investment Company Act*, Advisers Act Release No. 1562 (May 9, 1996), available on the SEC's website at http://www.sec.gov/rules/interp/33-7288.txt.

Investment Advisers Must Have a Code of Ethics Governing Their Employees and Enforce Certain Insider Trading Procedures

- Section 204A and Rule 204A-1 of the Advisers Act.
- *Investment Adviser Codes of Ethics*, Advisers Act Release No. 2256 (July 2, 2004), available on the SEC's website at http://www.sec.gov/rules/final/ia-2256.htm.
- SEC staff no-action letter, *Kleinwort Benson Investment Management Limited* (pub. avail. Dec. 15, 1993), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/kleinwort121593.htm.
- SEC staff no-action letter, *Corinne E. Wood (Herbert-Simon Co.)* (pub. avail. April 17, 1986), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/herbert-simon031886.htm.

Investment Advisers are Required to Maintain Certain Books and Records

- Rule 204-2 under the Advisers Act and Regulation S-P, privacy rules promulgated under Section 504 of the Gramm-Leach-Bliley Act.
- *Privacy of Consumer Financial Information (Regulation S-P)*, Advisers Act Release No. 1883 (June 22, 2000), which is available on the SEC's website at http://www.sec.gov/rules/final/34-42974.htm.
- *Electronic Recordkeeping by Investment Companies and Investment Advisers*, Advisers Act Release No. 1945 (May 24, 2001), which is available on the SEC's website at http://www.sec.gov/rules/final/ic-24991.htm.

Investment Advisers Must Seek to Obtain the Best Price and Execution for Their Clients' Securities Transactions

- Section 206 of the Advisers Act.
- *Interpretive Release Concerning Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters*, Exchange Act Release No. 23170 (Apr. 23, 1986), available on the SEC's website at http://www.sec.gov/rules/interp/34-23170.pdf.

- *Interpretation of Section 206(3) of the Investment Advisers Act of 1940*, Advisers Act Release No. 1732 (July 17, 1998), available on the SEC's website at http://www.sec.gov/rules/interp/ia-1732.htm.
- *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Release No. 54165 (July 18, 2006), available on the SEC's website at http://www.sec.gov/rules/interp/2006/34-54165.pdf.
- *In re Thompson and McKinnon*, Exchange Act Release No. 8310 (May 8, 1968), available on the SEC's website at http://www.sec.gov/litigation/opinions/34-8310.pdf.
- *In re Mark Bailey and Co.*, Advisers Act Release No. 1105 (Feb. 24, 1988), available on the SEC's website at http://www.sec.gov/litigation/admin/ia-1105.pdf.
- *In re Kingsley, Jennison, McNulty & Morse, Inc.*, Advisers Act Release No. 1396 (Dec. 23, 1993), available on the SEC's website at http://www.sec.gov/litigation/opinions/ia-1396.pdf.
- *In re Marvin & Palmer Associates, Inc.*, Advisers Act Release No. 1841 (Sept. 30, 1999), available on the SEC's website at http://www.sec.gov/litigation/admin/ia-1841.htm.
- SEC staff no-action letter, *United Missouri Bank of Kansas City, N.A.* (pub. avail. May 11, 1990), available on the SEC's website at http://www.sec.gov/investment/noaction/unitedmissouribank012395.htm.
- SEC staff no-action letter, *SMC Capital, Inc.* (pub. avail. Sept. 5, 1995), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/smccapital090595.htm.
- SEC staff no-action letter, *Pretzel & Stouffer* (Dec. 1, 1995), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/pretzelstouffer120195.htm.

Requirements for Investment Advisers' Contracts with Clients

- Section 205 of the Advisers Act.
- SEC staff no-action letter, *Auchincloss & Lawrence, Inc.* (pub. avail. Feb. 8, 1974) available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/auchincloss010874.htm.
- SEC staff no-action letter, *Heitman Capital Management LLC* (pub. avail. Feb. 12, 2007), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/2007/heitman021207.pdf.

Investment Advisers May be Examined by the SEC Staff

- Section 204 of the Advisers Act.

Requirements for Investment Advisers that Vote Proxies of Clients' Securities

- Rule 206(4)-6 and Rule 204-2(c)(2) under the Advisers Act.
- *Proxy Voting by Investment Advisers*, Advisers Act Release No. 2106 (Jan. 31,

2003), available on the SEC's website at http://www.sec.gov/rules/final/ia-2106.htm.

Requirements for Investment Advisers that Advertise their Services

- Section 206 and Rule 206(4)-1 under the Advisers Act.
- SEC staff no-action letter, *Clover Capital Management, Inc.* (pub. avail. Oct. 28, 1986), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/clovercapital102886.htm.
- SEC staff no-action letter, *Investment Company Institute*, (pub. avail. Sept. 23, 1988), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/ici092388.htm.
- SEC staff no-action letter, *Mandell Financial Group.* (pub. avail. May 21, 1997), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/mandell052197.htm.

Requirements for Investment Advisers that Pay Others Cash to Solicit New Clients

- Rule 206(4)-3 of the Advisers Act.

Requirements for Investment Advisers that have Custody or Possession of Clients' Funds or Securities

- Rule 206(4)-2 under the Advisers Act.
- Staff Responses to Questions about the Custody Rule at http://www.sec.gov/divisions/investment/custody_faq_030510.htm
- *Custody of Funds or Securities of Clients by Investment Advisers*, Advisers Act Release No. 2986 (Dec. 30, 2009), available on the SEC's website at http://www.sec.gov/rules/final/2009/ia-2968.pdf.
- SEC staff no-action letter, *Investment Adviser Association*, (pub. avail. Sept. 20, 2007), available on the SEC's website at http://www.sec.gov/divisions/investment/noaction/2007/iaa092007.pdf.

Requirements for Investment Advisers to Disclose Certain Financial and Disciplinary Information

- Rule 206(4)-4 under the Advisers Act.

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[1] The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any publication or statement by any of its employees. The views expressed herein are those of the staff and do not necessarily reflect the views of the Commission or the other staff members of the SEC.

[2] This information sheet contains descriptions of the Advisers Act, rules, Commission releases, court decisions, Commission orders and opinions, which impose or explain legal obligations. It also contains staff interpretations and no-action letters that have been issued by the Division of Investment Management. Staff interpretations and no-action letters provide informal interpretative and advisory assistance and represent the views of persons who are continuously working with the provisions of the Advisers Act. Opinions expressed by the staff, however, are not an official expression of the Commission's views and they do not have the force of law. You may wish to speak with an attorney or a compliance professional about specific

provisions and how they apply to your firm. This information is current as of June 2007.

[3] A complete report contains: the title and type of security; the exchange ticker symbol or CUSIP number; the number of shares, and principal amount of the security; the name of any broker, dealer or bank where the access person has an account that holds securities for the access person's direct or indirect benefit; and the date the access person submits the report.

[4] There are exceptions to this requirement. For example, an adviser is not required to provide regular account statements with respect to a registered investment company or a limited partnership (or another type of pooled investment vehicle) that is subject to an audit at least annually and that distributes its audited financial statements prepared in accordance with generally accepted accounting principles (GAAP) to all investors, generally within 120 days of the end of its fiscal year (under Rule 206(4)-2).

http://www.sec.gov/divisions/investment/advoverview.htm

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Office of Compliance Inspections and Examinations[1] Investment Adviser Examinations: Core Initial Request for Information

November 2008

The content of our initial request for information reflects the nature and extent of an adviser's business. For an adviser that provides only traditional money management services to non-fund clients, our initial request for information reflects the core services and related controls that typically exist in that environment. If an adviser's business has other features, the information initially requested will include both the core set of information described below and additional information that will allow the examination staff to evaluate compliance activities for these additional activities and relationships. Some of these additional activities and relationships include sponsoring a family of registered investment companies, sponsoring one or more privately offered funds, participating in PIPES offerings, participating in a separately managed account (wrap-fee) program, being also registered as a broker-dealer and being a manager of managers.

Background Regarding Requested Information

Each investment adviser registered with the Commission is required to adopt and implement written policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 (the "Advisers Act"), to review those policies and procedures at least annually for their adequacy and the effectiveness of their implementation, and to designate a chief compliance officer who is responsible for administering the policies and procedures (the "Compliance Rule" provisions are located in Rule 206(4)-7 under Advisers Act). The Compliance Rule is designed to protect investors by mandating that all advisers have internal programs to promote compliance with the Advisers Act. Each adviser should adopt policies and procedures that take into consideration the nature of that firm's operations. The policies and procedures should be designed to prevent violations from occurring, detect violations that have occurred, and correct promptly any violations that have occurred.

The initial phase of an examination includes a review of the firm's business and investment activities, its organizational affiliations and its corresponding compliance policies and procedures. The staff will request information and documents and speak with the firm's employees to ensure an understanding of the firm's business and investment activities and the operation of its compliance program. Using the information obtained, the staff will assess whether the firm's compliance policies and procedures appear to effectively address the firm's compliance risks. This work includes testing the firm's compliance program in particular areas.

The following points provide an overview of the core information the staff requests:

- Certain general information to provide an understanding of the firm's business and investment activities, including organizational charts, demographic and other data regarding advisory clients, and a record of all trades placed for its clients (trade blotter).
- Information about the compliance risks that the firm has identified (e.g., an inventory of compliance risks) and the written policies and procedures the firm has established and implemented to address each of those risks to provide an understanding of the firm's compliance risks and corresponding controls.
- Documents relating to the results of and output from the various transactional (quality control) and period (forensic) testing conducted to provide an understanding of how effectively a firm has implemented its compliance policies and procedures. This includes the results of any compliance reviews, quality control analyses, surveillance, forensic or transactional tests the firm has used to determine if activities have been performed as expected and to identify activities or transactions that have fallen short of or breached related policies and procedures.
- Information regarding the results of any tests and follow-up actions taken by the firm to address shortfalls or breaches revealed by such tests to provide an understanding of steps taken by the firm to address the results of compliance reviews, quality control, forensic or transactional tests conducted. This information might include, for example, warnings to or disciplinary action of employees, changes in policies or procedures, redress to affected clients, or other measures.
- Information to perform testing for compliance in various areas.

Core Initial Information Examiners Request

Described below are the types of core information that examiners will request during a routine examination of a typical money manager that does not engage in additional activities and/or have additional relationships. Also, for some of the items, a copy (either electronic or hard copy) may be requested, while examiners may only request access to other items.

General Information

- Organizational structure, affiliations, and control persons.
- Current and former officers and/or directors.
- Standard client advisory contracts or agreements.
- Sub-advisory agreements executed with other investment advisers.
- Fees and payments for services rendered.
- Power of attorney obtained from clients.
- Joint ventures or other businesses (with respect to the firm or any officer, director, portfolio manager, or trader).
- Disclosure documents and filings with regulators.
- Service providers and the services they perform.

- Remedial actions taken against supervised persons.
- Threatened, pending and settled litigation or arbitration involving the Adviser or any supervised person.

Information Regarding the Compliance Program, Risk Management and Internal Controls

- Compliance Program
    - Compliance policies and procedures in effect during the examination period.
    - Tests performed (i.e., compliance reviews, quality control analyses, surveillance, and/or forensic or transactional tests performed by the firm).
- On-going Risk Identification and Assessment
    - Inventory of compliance risks that forms the basis for policies and procedures and notations regarding changes made to the inventory.
    - Documents mapping the inventory of risks to written policies and procedures.
    - Written guidance provided to employees regarding compliance risk assessment process and procedures to mitigate and manage compliance risks.
- Internal audit review schedules and completed audits.
- Remote office and/or independent advisory contractor oversight process.
- Client complaints and correspondence and the process for monitoring such communications.
- Annual and/or interim reviews of policies and procedures, including interim reports.
- Record of non-compliance with the Code of Ethics.
- Valuation
    - Pricing services, quotation services, and externally-acquired portfolio accounting systems used in the valuation process and payment information.
    - Fair-valued and illiquid securities held by clients.
    - Advisory fee calculations.
- Information Processing, Reporting, and Protection
    - Regulation S-P guidance.
    - Controls of employee access to physical locations containing customer information.

  - Electronic access controls.
  - Business continuity plan.

Information to Facilitate Testing with Respect to Advisory Trading Activities

- Trade blotter.
- Advisory Information for Individual Clients
  - Current advisory client information regarding: account inception, type, balance, and management discretion; affiliation with the firm; custodial arrangements; account statement delivery; firm trading authority; services provided; investment strategy; portfolio manager; participation in composites; brokerage arrangements; fee computation; fee payment arrangements; and consultant related to obtaining the client, if any.
  - Advisory clients lost during review period.
- Portfolio Management
  - Securities held in all client portfolios, including information identifying each client holding an interest, the amount owned by each client, the aggregate number of shares or principal and/or notional amount held and total market value of the position.
  - Investment and/or portfolio management committee meetings and minutes, if held and maintained.
  - Publicly traded companies for which employees of the Adviser or its affiliates serve as officers and/or directors.
  - Companies for which employees of the adviser or its affiliates serve on creditors' committees.
  - Most profitable and least profitable investment decisions.
- Brokerage Arrangements
  - Brokerage arrangements and best execution evaluation documentation.
  - Soft dollar budget and products and services obtained using clients' brokerage commissions.
  - Commission-sharing arrangements.
  - Affiliated broker-dealers.
  - Securities in which the Adviser or an affiliate was a market maker.
  - Securities purchased for clients in which the firm or an affiliate underwrote or participated as underwriting manager, purchase group, and/or syndicate or selling group.
  - Trade errors and related information.

- Trade allocation information regarding initial public offerings and secondary offerings in which clients, proprietary accounts or access persons participated.
- Conflicts of Interest and/or Insider Trading
    - Code of Ethics and insider trading policies and procedures for firm and affiliates.
    - Exemptions from Code of Ethics for supervised persons.
    - Personal trading policies and procedures of contract employees and temporary employees.
    - Reports of securities transactions reported by access persons.
    - Non-public information control and monitoring procedures.
    - Fee splitting or revenue sharing arrangements.

Information to Perform Testing for Compliance in Various Areas

- Performance Advertising and/or Marketing
    - Pitch books, one-on-one presentations, pamphlets, brochures, and other promotional and/or marketing materials used for each investment strategy and/or mandate.
    - Advertisements used to inform or solicit clients.
    - Website access, if restricted.
    - Composite performance returns.
    - Accounts included in each composite and specific client account performance and supporting documentation for such clients.
    - Accounts not included in a composite.
    - Terminated composites.
    - Persons paying and compensation received for referring clients.
    - Third-party solicitor agreements, correspondence, compensation paid, and separate disclosure document.
    - Requests for proposals.
    - Third-party consultant questionnaires.
    - Global Investment Performance Standards compliance documentation.
- Financial Records
    - Balance sheet, trial balance, income statement, and cash flow statements.
    - Cash receipts and disbursements journal.

  - General ledger and chart of accounts.
  - Loans and sales of firm or affiliate's stock.
- Custody
  - Custodial confirmation that account statements are sent directly to clients.
  - Custodial confirmation of positions for specific clients.
- Anti-Money Laundering
  - Office of Foreign Assets Control ("OFAC") policies and procedures.
  - Internal Revenue Code ("IRC") and Bank Secrecy Act ("BSA") reporting procedures.

[1] The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the staff of the Office of Compliance Inspections and Examinations and do not necessarily reflect the views of the Commission or the other staff members of the SEC. Examinations indicating deficiencies generally result in (non-public) deficiency letters requesting that the firm take corrective action. Serious deficiencies may be referred to the SEC's enforcement staff.

http://www.sec.gov/info/cco/requestlistcore1108.htm

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REQUESTS FOR INDEPENDENT CONFIRMATION OF ASSETS:

The U.S. Securities and Exchange Commission ("SEC") conducts examinations of the books and records of securities firms and investment advisers that are regulated by the SEC. As part of these examinations, we may request independent confirmations of account balances directly with various persons, including clients or shareholders. These requests are made pursuant to a form called "*Account Information Confirmation.*" Please see below a blank copy of such a form.

If you receive an *Account Information Confirmation* regarding a securities firm or investment adviser with whom you do business, your response is voluntary, but your cooperation would be appreciated and would help us in our oversight of the regulated community. Also, please note that these requests may be made in any type of examination. We wish to emphasize that our request that you complete an *Account Information Confirmation* should in no way be an indication of any misconduct by the firm being inspected, any representative of the firm, and/or any other individual or entity.

In the past, examiners have made requests for independent confirmations of assets in forms that have differed from the model below. However, as of December 2012, all requests will be in this form.

If you have any questions or concerns about an *Account Information Confirmation,* do not hesitate to raise them with the examiners identified in the cover letter. In addition, if you wish to confirm that the request has been sent to you by SEC examiners, please call the main telephone number of the office that sent you the request and ask for the examiners identified in the cover letter. The telephone numbers of all SEC offices are available on the SEC's website at: http://www.sec.gov/contact/addresses.htm. Alternatively, if you prefer to speak with staff in the SEC headquarters office located in Washington D.C., please call the "Examination Hotline" at (202) 551-EXAM (3926).

Thank you for your cooperation.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
[REGIONAL OFFICE NAME/OCIE]
[ADDRESS]
[ADDRESS]

[Date]

[Client Name]
[Street Address]
[City, State Zip]

Re: Examination of [Firm Name]

Dear [Mr./Ms.][Name]:

The U.S. Securities and Exchange Commission conducts examinations of the books and records of securities firms and investment advisers that are regulated by the SEC. As part of these examinations, we may request independent confirmations of account balances directly with various persons, including clients or shareholders. We wish to emphasize that this request should in no way be construed as an indication of any misconduct by the firm being inspected, any representative of the firm, and/or any other individual or entity.

Attached you will find a form called "*Account Information Confirmation.*" We request that you complete this form and return it to **us** in the enclosed, self-addressed envelope. To facilitate the completion of our examination, we ask that you return the completed form within ten days.

Enclosed is a copy of a form (SEC Form 2866) that provides information for persons providing information to the SEC. This request for information is voluntary and you are not required to provide information in response to this letter.

We appreciate your cooperation with this routine request. If you have any questions regarding this routine request, please contact   at   . In addition, if you wish to confirm that I am an SEC examiner, please call the main telephone number of my office. The telephone numbers of all SEC offices are available on the SEC's website at: http://www.sec.gov/contact/addresses.htm. Alternatively, if you prefer to speak with staff in the SEC headquarters office located in Washington D.C., please call the "Examination Hotline" at (202) 551-EXAM (3926).

Sincerely,

[Name]
[Title]

Enclosures: Account Information Confirmation and Form 2866

ACCOUNT INFORMATION CONFIRMATION

[Client Name]
[Street Address]
[City, State Zip]

As of [Date], [Name of Adviser]'s records indicate that:

- the total balance of your account [give name of fund or type of account and account number, if available] was $[balance];
- your last deposit in the account was on [XX/XX/XXXX] in the amount of $[XXXX]; and
- your last withdrawal in the account was on [XX/XX/XXXX] in the amount of $[XXXX].

Please Check:

☐ This balance, deposit and withdrawal information *is* consistent with **the account statements sent directly to me by [Custodian].**

☐ This balance, deposit and withdrawal information is *not* consistent with **the account statements sent directly to me by [Custodian].**

(Please describe any inconsistencies in the space provided below.)

Account information confirmation is requested solely for the account identified above and for the date specified. If you have other accounts maintained or managed by this firm and would like to provide information on those other accounts, please do so in the space provided above. In addition, if you have account information for a date other than the date specified above and would like to comment on the information you have for the account identified as of the other date, you may provide information regarding the account and the other date in the space provided above.

Name (please print)

Name of Company (if applicable)

Signature/Date

Information Request List

Please provide the following items for the period ("Examination Period"):

General Information

1. Adviser's organization chart showing ownership percentages of the Adviser and control persons, and a schedule or chart of all affiliated entities.

2. Compliance policies and procedures that were in effect during the Examination Period for the Adviser and its affiliates. If not included specifically in the Compliance Manual, please provide and policies and procedures specific to:
   a. Adviser's wrap trading desk, including trade placement, order allocation, step-out trades, and best execution;
   b. Adviser's monitoring for wrap accounts with high cash balances;
   c. Adviser's monitoring for wrap accounts with low levels of trading;
   d. Adviser's oversight process of any branch offices and/or investment advisory representatives not located at the home office;
   e. Adviser's initial and on-going suitability reviews specific to wrap programs. If none, describe the factors used by the firm to determine the suitability of wrap clients initially and on an on-going basis.

3. Any compliance reviews (annual or otherwise) of Adviser's wrap trading for the Examination Period.

4. Provide the information below for all wrap fee programs managed by Adviser. The preferred format for this information is in Excel.

   a. Name of the wrap program;
   b. Name(s) of the investment manager(s);
   c. Name(s) of any sub-adviser(s);
   d. Program's inception date and termination date (if during the Examination Period);
   e. A brief description of the program's strategy and investments;
   f. Number of accounts in the program;
   g. Whether the portfolio manager (and/or sub-adviser) has discretionary authority over the account;
   h. Total value of the program's assets;
   i. Whether any of the accounts in the program custody their assets outside of the Adviser. If so, please provide the account names and their respective custodians;
   j. Total fee percentage charged by Sponsor
   k. Total fee percentage received by Adviser

5. Provide the information below for all current advisory clients, including privately offered funds. The preferred format for this information is in Excel.

   a. the account number, name and current balance, as of ;
   b. the name of the wrap program that the account participates in, if any.

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c. the type of account (*e.g.*, individual, defined benefit retirement plan, registered fund, or unregistered fund);
d. whether the client is a related person, affiliated person, or a proprietary account;
e. the account custodian and location;
f. whether or not the Adviser has discretionary authority;
g. the investment strategy (*e.g.*, global equity, high-yield, aggressive growth, long-short, or statistical arbitrage) and the performance composite in which it is included, if any;
h. the Account portfolio manager(s);
i. the value of each client's account that was used for purposes of calculating its advisory fee for the most recent billing period.

6. Documentation maintained regarding any reviews conducted of the Adviser's policies and procedures, including any annual and/or interim reports.

7. Any client complaints regarding Adviser's wrap fee programs.

8. Any threatened, pending and settled litigation or arbitration involving Adviser or any "supervised persons" regarding Adviser's wrap fee programs. Include a description of the allegations, the status, and a brief description of any "out of court" or informal settlement.

Disclosures

9. A copy of each standard client advisory contracts or agreements in place during the Examination Period, noting the date of any amendment.

10. Copies of the contracts between Adviser, sponsor, and the investment manager(s) for each wrap fee program listed above.

11. The Form ADV Part 2 furnished to clients during the Examination Period and any disclosure document used in conjunction with or in lieu of Part 2.

12. A copy of each wrap fee program's disclosure brochure furnished to clients during the Examination Period.

13. A list of all marketing materials used to promote wrap fee programs managed by Adviser.

Inactive Accounts

14. Any analysis conducted by Adviser to identify wrap accounts with low levels of trading.

15. Any analysis conducted by Adviser to identify wrap accounts with high cash balances.

16. A trade blotter (*i.e.*, purchases and sales journal) that lists transactions (including all trade errors, cancellations, re-bills, and reallocations) in securities and other financial instruments

(including privately offered funds) for: current and former clients; proprietary and/or trading accounts and access persons. The preferred format for this information is to provide it in Excel as indicated in Exhibit 1.

Transaction Fees

17. Any wrap trading desk best execution reviews conducted during the Examination Period.

18. State whether the firm permits advisers participating in its wrap programs to "trade away" from the firm's wrap trading desk. If so, please describe the conditions under which this is permissible (i.e. for best execution, for fixed income trades, for small-cap trades, for OTC trades, etc.).

19. State whether the firm's wrap trading desk has the ability to determine whether a wrap adviser is "trading away" from the wrap trading desk on a regular or ongoing basis. Please describe whether this activity is tracked and used in monitoring best execution and determining the suitability for wrap clients.

20. Describe any fees that a client may pay for financial products or services that are not offered as part of the bundled fee (transaction fee mutual funds, options, etc.), if applicable.

21. Describe any transaction-based fee that the Adviser may pay on behalf of the client (ticket charges, trade away fees, etc.), if applicable.

IDENTIFICATION OF RISKS/CYBERSECURITY GOVERNANCE

1. For each of the following practices employed by the Firm for management of information security assets, please provide the month and year in which the noted action was last taken; the frequency with which such practices are conducted; the group with responsibility for conducting the practice; and, if not conducted firmwide, the areas that are included within the practice. Please also provide a copy of any relevant policies and procedures.

   - Physical devices and systems within the Firm are inventoried
   - Software platforms and applications within the Firm are inventoried.
   - Maps of network resources, connections, and data flows (including locations where customer data is housed) are created or updated.
   - Connections to the Firm's network from external sources are categorized.
   - Resources (hardware, data, and software) are prioritized for protection based on their sensitivity and business value.
   - Logging capabilities and practices are assessed for adequacy, appropriate retention, and secure maintenance

2. Please provide a copy of the Firm's written information security policy.

3. Please indicate whether the Firm conducts periodic risk assessments to identify cybersecurity threats, vulnerabilities, and potential business consequences. If such assessments are conducted:

   a. Who (business group/title) conducts them, and in what month and year was the most recent assessment completed?

   b. Please describe any findings from the most recent risk assessment that were deemed to be potentially moderate or high risk and have not yet been fully remediated.

4. Please indicate whether the Firm conducts periodic risk assessments to identify physical security threats and vulnerabilities that may bear on cybersecurity. If such assessments are conducted:

   a. Who (business group/title) conducts them, and in what month and year was the most recent assessment completed?

b. Please describe any findings from the most recent risk assessments that were deemed to be potentially moderate or high risk and have not yet been fully remediated.

5. If cybersecurity roles and responsibilities for the Firm's workforce and managers have been explicitly assigned and communicated, please provide written documentation of these roles and responsibilities. If no written documentation exists, please provide a brief description.

6. Please provide a copy of the Firm's written business continuity of operations, plan that addresses mitigation of the effects of a cybersecurity incident and/or recovery from such an incident if one exists.

7. Does the Firm have a Chief Information Security Officer or equivalent position? If so, please identify the person and title. If not, where does principal responsibility for overseeing cybersecurity reside within the Firm?

8. Does the firm maintain insurance that specifically covers losses and expenses attributable to cybersecurity incidents? If so, please briefly describe the nature of the coverage and indicate whether the Firm has filed any claims, as well as the nature of the resolution of those claims.

<u>Protection of Firm Networks and Information</u>

9. Please identify any published cybersecurity risk management process standards, such as those issued by the National Institute of Standards and Technology (NIST) or the International Organization for Standardization (ISO), the Firm has used to model its information security architecture and processes.

10. Please indicate which of the following practices and controls regarding the protection of its networks and information are utilized by the Firm, and provide any relevant policies and procedures for each item.

    - The Firm provides written guidance and periodic training to employees concerning information security risks and responsibilities. If the Firm provides such guidance and/or training, please and which groups of employees participated in each training event conducted since January 1, 2013.

    - The Firm restricts users to those network resources necessary for their business functions. If so, please describe those controls, unless fully described within policies and procedures.

- The Firm maintains an environment for testing and development of software and applications that is separate from its business environment.

- The Firm maintains a baseline configuration of hardware and software, and users are prevented from altering that environment without authorization and an assessment of security implications.

- The Firm has a process to manage IT assets through removal, transfers, and disposition.

- The Firm has a process for ensuring regular system maintenance, including timely installation of software patches that address security vulnerabilities.

- The Firm's information security policy and training address removable and mobile media.

- The Firm maintains protection against Distributed Denial of Service (DDoS) attacks for critical internet-facing IP addresses. If so, please describe the internet functions protected and who provides this protection.

- The Firm maintains a written data destruction policy.

- The Firm maintains a written cybersecurity incident response policy. If so, please provide a copy of the policy and indicate the year in which it was most recently updated. Please also indicate whether the Firm conducts tests or exercises to assess its incident response policy, and if so, when and by whom the last such test or assessment was conducted.

- The Firm periodically tests the functionality of its backup system. If so, please provide the month and year in which the backup system was most recently tested.

11. Please indicate whether the Firm makes use of encryption. If so, what categories of data, communications, and devices are encrypted and under what circumstances?

12. Please indicate whether the Firm conducts periodic audits of compliance with its information security policies. If so, in what month and year was the most recent such audit completed, and by whom was it conducted?

<u>Risks Associated With Remote Customer Access and Funds Transfer Requests</u>

13. Please indicate whether the Firm provides customers with on-line account access. If so, please provide the following information:

    a. The name of any third party or parties that manage the service.

b. The functionality for customers on the platform (*e.g.*, balance inquiries, address and contact information changes, beneficiary changes, transfers among customer's accounts, withdrawals or other external transfers of funds).

c. How customers are authenticated for on-line account access and transactions.

d. Any software or other practice employed for detecting anomalous transaction requests that may be the result of compromised customer account access.

e. A description of any security measure used to protect consumer PINs stored on the sites.

f. Any information given to customers about reducing cybersecurity risks in conducting transactions/business with the Firm.

14. Please provide a copy of the Firm's procedures for verifying the authenticity of email requests seeking to transfer customer funds. If no written procedures exist, please describe the process.

15. Please provide a copy of any Firm policies for addressing responsibility for losses associated with attacks or intrusions impacting customers.

    a. Does the Firm offer its customers a security guarantee to protect them against hacking of their accounts? If so, please provide a copy of the guarantee if one exists and a brief description.

Risks Associated With Vendors and Other Third Parties

16. If Firm conducts or requires cybersecurity risk assessments of vendors and business partners with access to Firm's networks, customer data, or other sensitive information, or due to the cybersecurity risk of the outsourced function, please describe who conducts this assessment, when it is required, and how it is conducted. If a questionnaire is used, please provide a copy. If assessments by independent entities are required, please describe any standards established for such assessments.

17. If the Firm regularly incorporates requirements relating to cybersecurity risk into its contracts with vendors and business partners, please describe these requirements and circumstances in which they are incorporated. Please provide a sample copy.

18. Please provide a copy of policies and procedures and any training materials related to information security procedures and responsibilities for trainings conducted since January 2013 for vendors and business partners authorized to access its network.

19. If the Firm assesses the segregation of sensitive network resources from resources accessible to third parties, who (business group title) performs this assessment, and provide a copy of any relevant policies and procedures?

20. If vendors, business partners, or other third parties may conduct remote maintenance of the Firm's networks and devices, describe any approval process, logging process, or controls to prevent unauthorized access, and provide a copy of any relevant policies and procedures.

Detection of Unauthorized Activity

21. For each of the following practices employed by the Firm to assist in detecting unauthorized activity on its networks and devices, please briefly explain how and by whom (title, department and job function) the practice is carried out.

    - Identifying and assigning specific responsibilities by job function, for detecting and reporting suspected unauthorized activity.
    - Maintaining baseline information about expected events on Firm's network.
    - Aggregating and correlating event data from multiple sources.
    - Establishing written incident alert thresholds.
    - Monitoring the Firm's network environment to detect potential cybersecurity events.
    - Monitoring the Firm's physical environment to detect potential cybersecurity events.
    - Using software to detect malicious code on Firm networks and mobile devices.
    - Monitoring the activity of third party service providers with access to Firm's networks.
    - Monitoring the presence of unauthorized users, devices, connections, and software on the Firm's networks.
    - Evaluating remotely-initiated requests for transfers of customer assets to identify anomalous and potentially fraudulent requests.
    - Using data loss prevention software.
    - Conducting penetration tests and vulnerability scans. If so, please identify the month and year of the most recent penetration test and recent vulnerability scan, whether they were conducted by Firm employees or third parties, and describe any findings from the most

recent risk test and/or assessment that were deemed to be potentially moderate or high risk but have not yet been addressed.

- Testing the reliability of event detection processes. If so, please identify the month and year of the most recent test.

- Testing reliability of event detection processes. If so, please identify the month and year of the most recent test.

- Using the analysis of events to improve the Firm's defensive measures and policies.

Other

22. Did the Firm update its written supervisory procedures to reflect the Identity Theft Red Flags Rules, which became effective in 2013 (17 CFR § 248 – Subpart C – Regulation S-ID)?

    a. If not, why?

23. How does the Firm identify relevant best practices regarding cybersecurity for its business model?

24. **Since January 1, 2013**, has your Firm experienced any of the following types of events? If so, please provide a brief summary for each category listed below, identifying the number of such incidents (approximations are acceptable when precise numbers are not readily available) and describing their significance and any effects on the Firm, its customers, and its vendors or affiliates. If the response to any one item includes more than 10 incidents, the respondent may note the number of incidents and describe incidents that resulted in losses of more than $5,000, the unauthorized access to customer information, or the unavailability of a Firm service of more than 10 minutes. The record or description should, at a minimum include: the extent to which losses were incurred, customer information accessed, and Firm services impacted; the date of the incident; the date the incident was discovered and the remediation for such incident.

    - Malware was detected on one or more Firm devices. Please identify or describe the malware.

    - Access to a Firm web site or network resource was blocked or impaired by a denial of service attack. Please identify the service affected, and the nature and length of the impairment.

    - The availability of a critical Firm web or network resource was impaired by a software or hardware malfunction. Please identify the service affected, the nature and length of the impairment, and the cause.

- The Firm's network was breached by an authorized user. Please describe the nature, duration, and consequences of the breach, how the Firm learned of it, and how it was remediated.

- The compromise of a customer's or vendor's computer used to remotely access the Firm's network resulted in fraudulent activity, such as efforts to fraudulently transfer funds from a customer account or the submission of fraudulent payment requests purportedly on behalf of a vendor.

- The Firm received fraudulent emails, purportedly from customers, seeking to direct transfers of customer funds or securities.

- The Firm was the subject of an extortion attempt by an individual or group threatening to impair access to or damage the Firm's data, devices, network, or web services.

- An employee or other authorized user of the Firm's network engaged in misconduct resulting in the misappropriation of funds, securities, sensitive customer or Firm information, or damage to the Firm's network or data.

25. **Since January 1, 2013**, if not otherwise reported above, did the Firm, either directly or as a result of an incident involving a vendor, experience the theft, loss, unauthorized exposure, or unauthorized use of or access to customer information? Please respond affirmatively even if such an incident resulted from an accident or negligence, rather than deliberate wrongdoing. If so, please provide a brief summary of each incident or a record describing each incident.

26. For each event identified in response to Questions 24 and 25 above, please indicate whether it was reported to the following:

    - Law enforcement (please identify the entity)
    - FinCEN (through the filing of a Suspicious Activity Report)
    - FINRA
    - A state or federal regulatory agency (please identify the agency and explain the manner of reporting)
    - An industry or public-private organization facilitating the exchange of information about cybersecurity incidents and risks

27. What does the Firm presently consider to be its three most serious cybersecurity risks, and why?

28. Please feel free to provide any other information you believe would be helpful to the Securities and Exchange Commission in evaluating the cybersecurity posture of the Firm or the securities industry.

FOIA Confidential Treatment Request

January XX, 2013

VIA FACSIMILE and FEDERAL EXPRESS
Mr. Lead Examiner
United States Securities and Exchange Commission
Denver Regional Office
1801 California Street, Suite 1500
Denver, Colorado 80202-2656

Re: Examination of Firm XXOX (the "Registrant")

Dear Lead Examiner:

Firm XXOX hereby request FOIA confidential treatment pursuant to 17 C.F.R. 200.83 on all of the documents provided in response to the Securities and Exchange Commission's 2013 examination of Firm XXOX (the "Registrant") to address client and shareholder confidentiality, information about Registrant's employees, financial advisors, sales, marketing, pricing, and compensation that is not publicly disclosed, and business and financial information concerning the Registrant that is not publicly available and could be used to the advantage of its competitors. Each page of the documents includes a unique alphanumeric reference in the right hand bottom corner which is comprised of the year provided to the SEC (2013), a three letter abbreviation ("SEC"), and a document number (01, 02, 03, etc.). A "FOIA Confidential Treatment Document Log" is attached to this letter that indicates the files transmitted to you on the following dates ________________________________. As this is not the end of the production of documents and information during this examination, Registrant will continue to log the document via the alpha numeric reference noted above and provide a final log to both you and the FOIA office upon the completion of the exam.

A copy of this request and the FOIA Confidential Treatment Document Log has been forwarded to the FOIA office via fax transmission. The Registrant further requests confidential treatment of this response, under the Freedom of Information Act and Rule 45a-1 under the 1940 Act, and a separate letter has been forwarded to the Chairman, Securities and Executive Commission, Washington, DC.

This letter is being provided to you voluntarily in connection with the matters discussed herein and confidential treatment is requested for reasons stated above. Accordingly, please inform one of the individuals named below of any request under the Freedom of Information Act seeking access to any of the foregoing records, including this letter, to enable us to substantiate the grounds for confidential treatment, unless the Commission intends to deny such request for access on other grounds. Also, the production of the any associated documents and the provision of information responsive to the SEC Staff's request is not intended to be construed in any manner as a waiver of any privilege or right which otherwise would be available to the Registrants or any affiliate of the Registrants.

Should you have any questions concerning this response to the Letter, please contact____________.

Respectfully submitted,

PowerPoint Presentation:

Administrative Enforcement and Procedures

By Ryan Kriegshauser

Slide 1

OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Administrative Procedures

Presenter: Ryan Kriegshauser

Kansas
Office of the Securities Commissioner

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Slide 2

Question: Who can be subject to a KSC Administrative Hearing?

A) Only Kansas Registrants.

B) Registrants in Kansas or any other state.

C) Anyone who violates the Kansas Uniform Securities Act if the KSC can get service of process.

D) Anyone who violates the Kansas Uniform Securities Act with a connection to Kansas.

See K.S.A. 17-12a604(a); K.S.A. 17-12a610; and K.S.A. 17-12a611

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Slide 3

Legal Background

- Kansas Uniform Securities Act (KUSA): K.S.A. 17-12a101 *et seq.*
- Kansas Administrative Procedure Act (KAPA): K.S.A. 77-501 *et seq.*
- Kansas Judicial Review Act: K.S.A. 77-601 *et seq.*
- Kansas Regulations: K.A.R. 81-11-1 *et seq.*

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Slide 4

Overview

- Types of Administrative Cases:
  - Registered Cases
    - Suitability
    - Churning
    - Non-disclosure/Misrepresentation
    - Unregistered Sales
  - Unregistered Cases
    - Fraud
    - Unregistered Sales

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Kansas Office of the Securities Commissioner

Slide 5

Overview Cont'd

- Types of Administrative Actions
  - Orders
  - Notice of Intent
- Types of Hearings
  - Formal Hearings
  - Conference Hearings
  - Summary Hearings

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Kansas Office of the Securities Commissioner

Slide 6

Question: How many days does a party have to request a hearing?

A) 30 days from the when the Respondent was handed the initiating document in person.

B) 30 days from when the initiating document was mailed.

C) 33 days from when the initiating document was mailed.

D) 30 days from when the initiating document was left at the Respondent's place of business.

E) 30 days from when the KSC receives the initiating document.

6 *See* K.S.A. 17-12a604(c); K.S.A. 77-531; and K.S.A. 17-12a611

Kansas Office of the Securities Commissioner

Slide 7

Requesting a Hearing

- K.A.R. 81-11-5 Requires:
  - Title of the matter
  - Docket Number
  - Request for hearing stating the type of hearing requested
  - Disputed allegations
  - Contact information for counsel
  - Verification

Kansas Office of the Securities Commissioner

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Slide 8

Prehearing Activities

- Scheduling Conferences
- Discovery
- Motions

See K.S.A.77-516-517; K.S.A. 77-519; and K.S.A. 77-522

Kansas Office of the Securities Commissioner

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Slide 9

Question: Is hearsay evidence allowed in a KSC administrative hearing?

A) Strictly in accordance with the Rules of Evidence.

B) Always.

C) Only if the Commissioner finds that the evidence will aid in ascertaining facts.

D) If it is reasonable to admit it.

E) Not if a party objects.

See K.S.A. 77-524; K.A.R. 81-11-10

Kansas Office of the Securities Commissioner

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Slide 10

Hearing Procedure

- Formal Hearings
- Conference Hearings

See K.S.A. 77-533-34; K.S.A. 77-523; and K.A.R. 81-11-6

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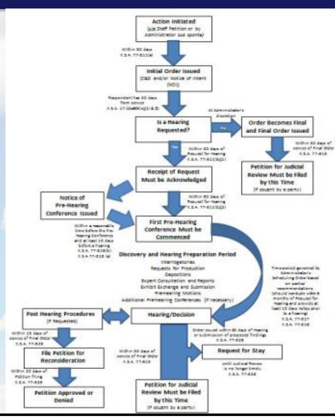
Kansas Office of the Securities Commissioner

Slide 11

Formal Hearing



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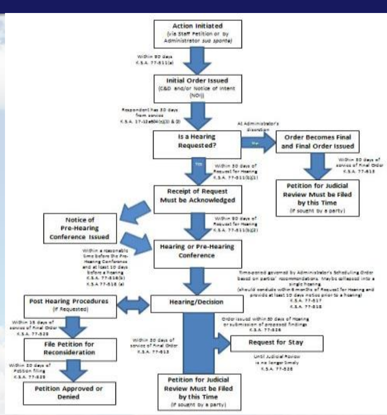
Kansas Office of the Securities Commissioner

Slide 12

Conference Hearing

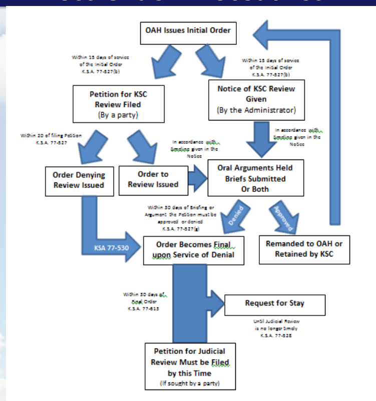


12

Kansas Office of the Securities Commissioner

Slide 13

Interactions with the Office of Administrative Hearings (OAH) and Post-Order Procedures



Kansas Office of the Securities Commissioner

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Slide 14

Question: How much may the KSC issue as a civil penalty in an administrative case?

A) Up to $10,000 per violation to a total of $500,000

B) Up to $50,000 per violation to a total of $1,000,000

C) Up to $25,000 per violation to a total of $1,000,000

D) Up to $100,000 per violation to a total of 5,000,000

See K.S.A. 17-12a604

Kansas Office of the Securities Commissioner

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Slide 15

Administrative Procedures

Questions?

Kansas Office of the Securities Commissioner

15

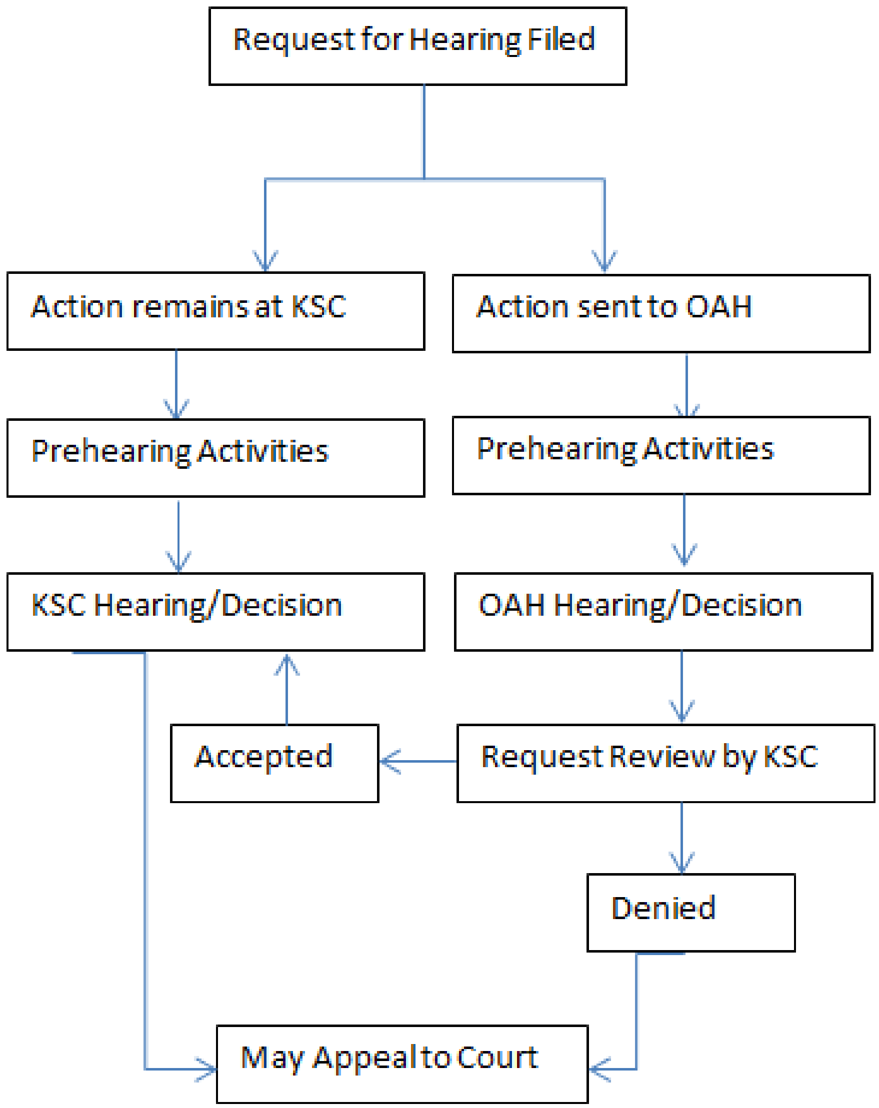
Supplemental Materials:

Administrative Enforcement and Procedures

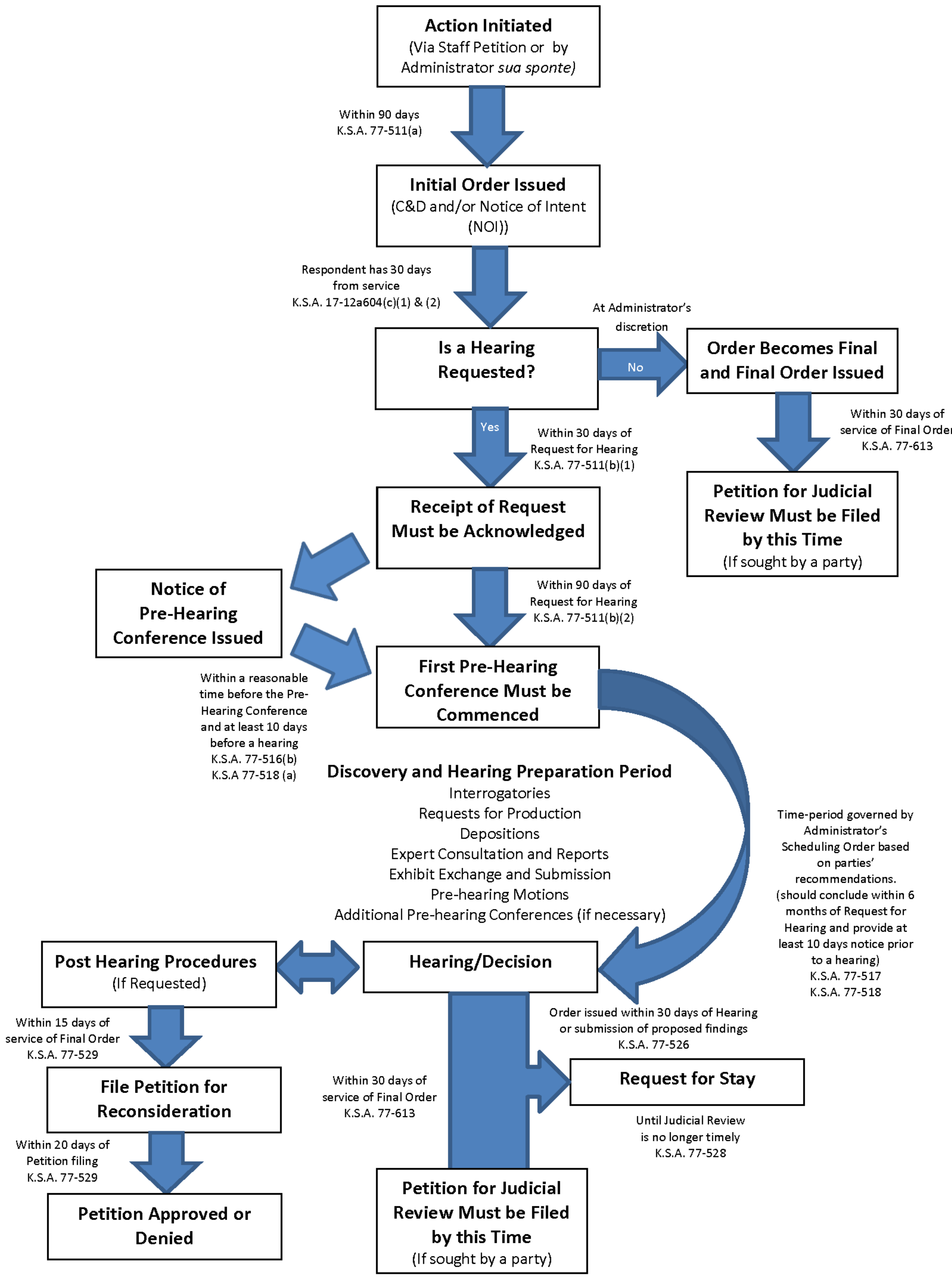
By Ryan Kriegshauser

Kansas Office of the Securities Commissioner

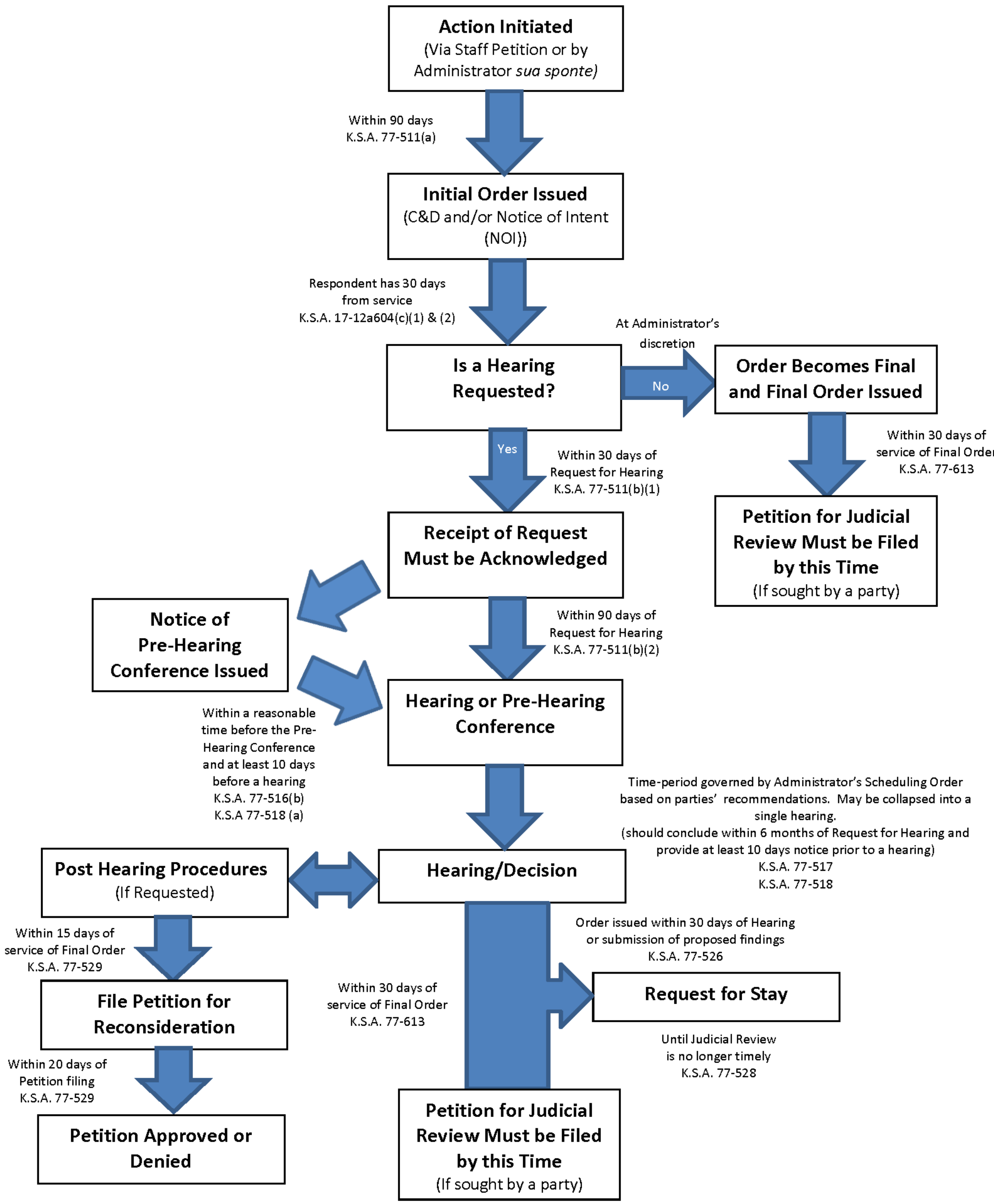
OAH v. KSC Processes



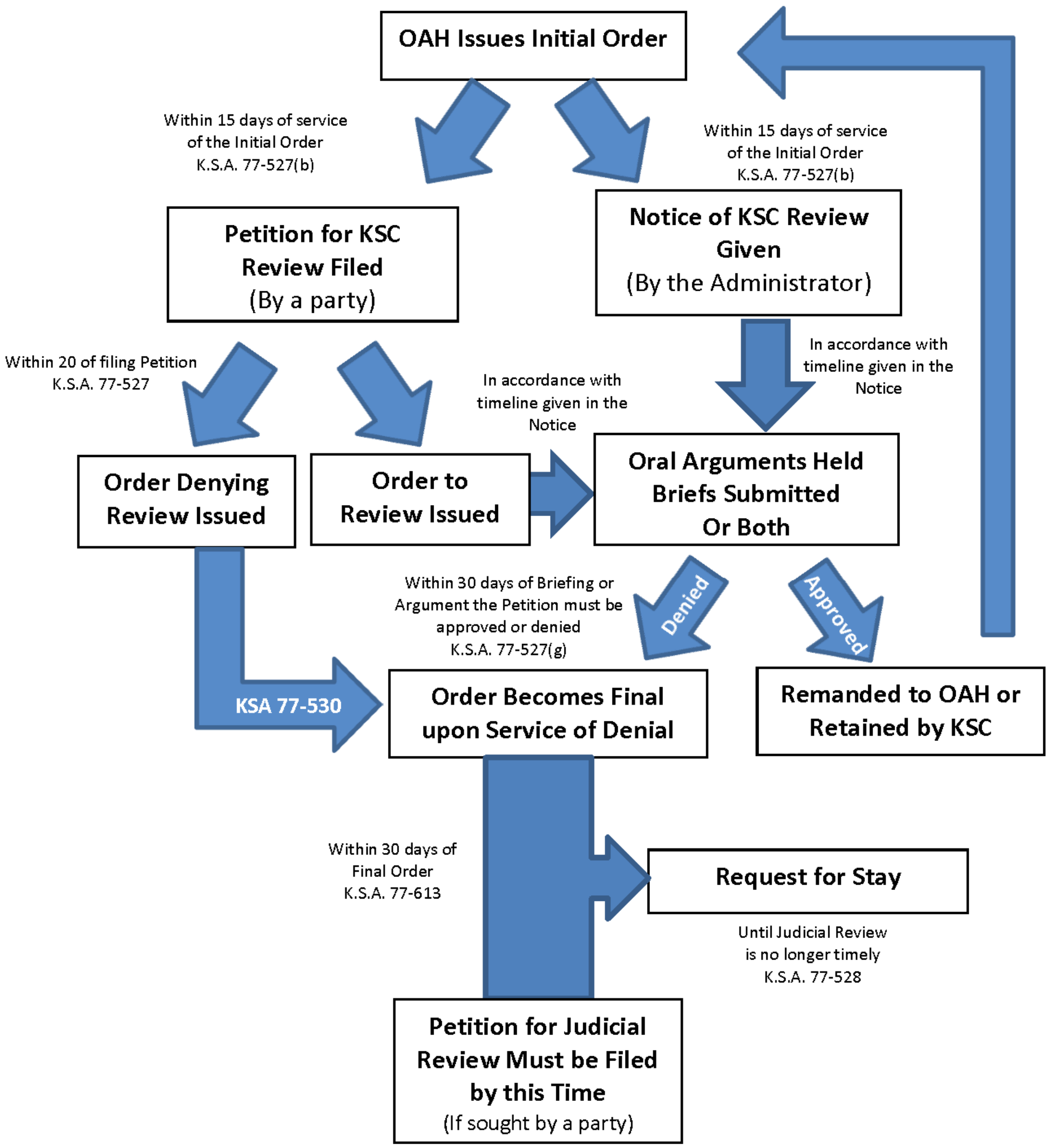
Formal Hearing



Conference Hearing



Interaction with OAH and Post-Order Procedures



109 SW 9th Street
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Kansas
Office of the Securities Commissioner

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Investor Services: 1-800-232-9580
www.ksc.ks.gov

Joshua A. Ney, Commissioner

Sam Brownback, Governor

Excerpts from Kansas Statutes Governing Administrative Procedure

K.S.A. 17-12a604. Administrative Enforcement. (a) *Cease and desist order.* If the administrator finds that a person has engaged, is engaging, or is about to engage in an act, practice, or course of business constituting a violation of this act or a rule adopted or order issued under this act or that a person has materially aided, is materially aiding, or is about to materially aid an act, practice, or course of business constituting a violation of this act or a rule adopted or order issued under this act, the administrator may: (1) Issue an order directing the person to cease and desist from engaging in the act, practice, or course of business or to take other action necessary or appropriate to comply with this act; (2) issue an order denying, suspending, revoking, or conditioning the exemptions for a broker-dealer under K.S.A. 17-12a401(b)(1)(D) or (F), and amendments thereto, or an investment adviser under K.S.A. 17-12a403(b)(1)(C), and amendments thereto; or (3) issue an order under K.S.A. 17-12a204, and amendments thereto.

(b) *Additional administrative sanctions and remedies.* If the administrator finds, by written findings of fact and conclusions of law, that a person has violated this act or a rule adopted or order issued under this act, the administrator, in addition to any other power granted under this act, may enter an order against the person containing one or more of the following sanctions or remedies: (1) A civil penalty up to $25,000 for each violation. If any person is found to have violated any provision of this act, and such violation is committed against elder or disabled persons, as defined in K.S.A. 50-676, and amendments thereto, in addition to any civil penalty otherwise provided by law, the administrator may impose an additional penalty not to exceed $15,000 for each such violation. The total penalty against a person shall not exceed $1,000,000; (2) a bar or suspension from association with a broker-dealer or investment adviser registered in this state; (3) an order requiring the person to pay restitution for any loss or disgorge any profits arising from the violation, including, in the administrator's discretion, the assessment of interest from the date of the violation at the rate provided for interest on judgments by K.S.A. 16-204, and amendments thereto; or (4) an order charging the person with the actual cost of the investigation or proceeding.

(c) *Procedures for orders.* (1) An order under subsection (b) shall not be entered unless the administrator first provides notice and opportunity for hearing in accordance with the provisions of the Kansas administrative procedures act. (2) An order under subsection (a) is effective on the date of issuance. Upon issuance of the order, the administrator shall promptly serve each person subject to the order with a copy of the order. The order must include a statement of the reasons for the order and notice that upon receipt of a written request the matter will be set for a hearing which shall be conducted in accordance with the provisions of the Kansas administrative procedures act. If a person subject to the order does not request a hearing and none is ordered by the administrator within 30 days after the date of service of the order, the order becomes final as to that person by operation of law. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing to each person subject to the order, may modify or vacate the order or extend it until final determination. (3) An order under subsection (a) may contain a notice of the administrator's intent to seek administrative sanctions or remedies under subsection (b). If the person subject to the order does not request a hearing and none is ordered by the administrator within 30 days after service of the order, the administrator may modify the order to include sanctions or remedies under subsection (b). If a hearing is requested or ordered, the administrator, after notice and opportunity for hearing, shall by written findings of fact and conclusions of law vacate, modify, or make permanent the order, and the administrator may modify the order to include sanctions or remedies under subsection (b).

(d) *Filing of certified final order with court; effect of filing.* If a petition for judicial review of a final order is not filed in accordance with K.S.A. 17-12a609, and amendments thereto, the administrator may file a certified copy of the final order with the clerk of a court of competent jurisdiction. The order so filed has the same effect as a judgment of the court and may be recorded, enforced, or satisfied in the same manner as a judgment of the court.

(e) *Enforcement by court; further civil penalty.* If a person does not comply with an order under this section, the administrator may petition a court of competent jurisdiction to enforce the order. The court may not require the administrator to post a bond in an action or proceeding under this section. If the court finds, after service and opportunity for hearing, that the person was not in compliance with the order, the court may adjudge the person in civil contempt of the order. The court may impose a further civil penalty against the person for contempt in an amount not greater than $25,000 for each violation and may grant any other relief the court determines is just and proper in the circumstances.

K.S.A. 17-12a610. Jurisdiction. (a) *Sales and offers to sell.* K.S.A. 17-12a301, 17-12a302, 17-12a401(a), 17-12a402(a), 17-12a403(a), 17-12a404(a), 17-12a501, 17-12a506, 17-12a509, and 17-12a510, and amendments thereto, do not apply to a person that sells or offers to sell a security unless the offer to sell or the sale is made in this state or the offer to purchase or the purchase is made and accepted in this state.

(b) *Purchases and offers to purchase.* K.S.A. 17-12a401(a), 17-12a402(a), 17-12a403(a), 17-12a404(a), 17-12a501, 17-12a506, 17-12a509, and 17-12a510, and amendments thereto, do not apply to a person that purchases or offers to purchase a security unless the offer to purchase or the purchase is made in this state or the offer to sell or the sale is made and accepted in this state.

(c) *Offers in this state.* For the purpose of this section, an offer to sell or to purchase a security is made in this state, whether or not either party is then present in this state, if the offer: (1) Originates from within this state; or (2) is directed by the offeror to a place in this state and received at the place to which it is directed.

(d) *Acceptances in this state.* For the purpose of this section, an offer to purchase or to sell is accepted in this state, whether or not either party is then present in this state, if the acceptance: (1) Is communicated to the offeror in this state and the offeree reasonably believes the offeror to be present in this state and the acceptance is received at the place in this state to which it is directed; and (2) has not previously been communicated to the offeror, orally or in a record, outside this state.

(e) *Publications, radio, television or electronic communications.* An offer to sell or to purchase is not made in this state when a publisher circulates or there is circulated on the publisher's behalf in this state a bona fide newspaper or other publication of general, regular and paid circulation that is not published in this state, or that is published in this state but has had more than two-thirds of its circulation outside this state during the previous 12 months or when a radio or television program or other electronic communication originating outside this state is received in this state. A radio or television program, or other electronic communication is considered as having originated in this state if either the broadcast studio or the originating source of transmission is located in this state, unless: (1) The program or communication is syndicated and distributed from outside this state for redistribution to the general public in this state; (2) the program or communication is supplied by a radio, television or other electronic network with the electronic signal originating from outside this state for redistribution to the general public in this state;
(3) the program or communication is an electronic communication that originates outside this state and is captured for redistribution to the general public in this state by a community antenna or cable, radio, cable television or other electronic system; or (4) the program or communication consists of an electronic communication that originates in this state, but which is not intended for distribution to the general public in this state.

(f) *Investment advice and misrepresentations.* K.S.A. 17-12a403(a), 17-12a404(a), 17-12a405(a), 17-12a502, 17-12a505, and 17-12a506, and amendments thereto, apply to a person if the person engages in an act, practice, or course of business instrumental in effecting prohibited or actionable conduct in this state, whether or not either party is then present in this state.

K.S.A. 17-12a611. Service of Process. (a) *Signed consent to service of process.* A consent to service of process required by this act must be signed and filed in the form required by a rule or order under this act. A consent appointing the administrator the person's agent for service of process in a noncriminal action or proceeding against the person, or the person's successor or personal representative under this act or a rule adopted or order issued under this act after the consent is filed, has the same force and validity as if the service were made personally on the person filing the consent. A person that has filed a consent complying with this subsection in connection with a previous application for registration or notice filing need not file an additional consent.

(b) *Conduct constituting appointment of agent for service.* If a person, including a nonresident of this state, engages in an act, practice, or course of business prohibited or made actionable by this act or a rule adopted or order issued under this act and the person has not filed a consent to service of process under subsection (a), the act, practice, or course of business constitutes the appointment of the administrator as the person's agent for service of process in a noncriminal action or proceeding against the person or the person's successor or personal representative.

(c) *Procedure for service of process.* Service under subsection (a) or (b) may be made by providing a copy of the process to the office of the administrator, but it is not effective unless: (1) The plaintiff, which may be the administrator, promptly sends notice of the service and a copy of the process, return receipt requested, to the defendant or respondent at the address set forth in the consent to service of process or, if a consent to service of process has not been filed, at the last known address, or takes other reasonable steps to give notice; and (2) the plaintiff files an affidavit of compliance with this subsection in the action or proceeding on or before the return day of the process, if any, or within the time that the court, or the administrator in a proceeding before the administrator, allows.

(d) *Service in administrative proceedings or civil actions by administrator.* Service pursuant to subsection (c) may be used in a proceeding before the administrator or by the administrator in a civil action in which the administrator is the moving party. In an administrative proceeding under this act, service of process may also be made in accordance with the Kansas administrative procedure act.

(e) *Opportunity to defend.* If process is served under subsection (c), the court, or the administrator in a proceeding before the administrator, shall order continuances as are necessary or appropriate to afford the defendant or respondent reasonable opportunity to defend.

K.S.A. 77-531. Service of Order or Notice. Service of an order or notice shall be made upon the party and the party's attorney of record, if any, by delivering a copy of the order or notice to the person to be served or by mailing a copy of the order or notice to the person at the person's last known address. Service shall be presumed if the presiding officer, or a person directed to make service by the presiding officer, makes a written certificate of service. Delivery of a copy of an order or notice means handing the order or notice to the person or leaving the order or notice at the person's principal place of business or residence with a person of suitable age and discretion who works or resides therein. Service by mail is complete upon mailing. Whenever a party has the right or is required to do some act or take some proceedings within a prescribed period after service of a notice or order and the notice or order is served by mail, three days shall be added to the prescribed period.

K.A.R. 81-11-5. Request for Hearing. (a) When the commissioner has entered any emergency or summary order or given notice of intent to issue any order, an aggrieved party may file a written request for a hearing. The request shall be filed in the office of the commissioner within 30 days of service of the order or notice of intent.

(b) The request for hearing shall contain the following: (1) the title of the matter as written on the commissioner's order or notice; (2) the docket number of the matter; (3) a request for a hearing and if allegations of the commissioner's staff are disputed and the aggrieved party desires a formal adjudicatory proceeding, a statement to that effect; (4) a detailed statement of what allegations in the staff's pleadings are disputed by the aggrieved party. All allegations not disputed in the request shall be found to be admitted by the aggrieved party; (5) the name, address, and phone number of any local and any foreign counsel; and (6) a sworn verification by the requesting party that the contents of the request are true. If the aggrieved party is an individual, the verification shall be signed by the individual. If the aggrieved party is a corporation, the verification shall be signed by the president or the chairman of the board of directors. If the aggrieved party is a partnership, the verification shall be signed by a general partner. If the aggrieved party is a governmental unit, the verification shall be signed by the highest official in the unit or a deputy.

(c) Failure of an aggrieved party to file a request for hearing in substantial compliance with this section shall constitute grounds for denial of the request.

(d) No hearing shall be granted to an aggrieved party unless a timely request for hearing has been filed, but the commissioner may grant a hearing upon the commissioner's own motion or upon the request of the commissioner's staff.

K.A.R. 81-11-6. Conference adjudicative proceedings. Unless an aggrieved party has requested a formal adjudicatory proceeding in accordance with K.A.R 81-11-5(b) (3) and has disputed staff allegations in accordance with K.A.R. 81-11-5(b) (4), or unless another type of proceeding is ordered or otherwise required, any proceeding granted shall be a conference adjudicative proceeding.

K.A. R. 81-11-7. Appearances. (a) The filing of a request for hearing shall constitute a general appearance before the commissioner by the requesting party and shall act as an acknowledgment that service of the order or notice was complete upon the requesting party. No special appearance shall be recognized.

(b) If an aggrieved party appears in any proceeding with an attorney, service upon the aggrieved party is complete upon service of the attorney.

(c) Any attorney who will appear with an aggrieved party and who was not named in the request for hearing, shall file a written appearance stating the attorney's name, address and telephone number, and specifying whom the attorney will represent in the proceeding.

(d) The person who signed the verification on the request for hearing shall appear personally at the hearing. Failure to so appear shall constitute grounds for default against the aggrieved party who filed the request for hearing. Appearance by attorney only or by another controlling person shall be insufficient unless permitted by the commissioner for good cause shown. Any person so permitted to appear shall verify an amended request for hearing.

K.S.A. 77-524. Evidence; Official Notice. (a) A presiding officer need not be bound by technical rules of evidence, but shall give the parties reasonable opportunity to be heard and to present evidence, and the presiding officer shall act reasonably without partiality. The presiding officer shall give effect to the rules of privilege recognized by law. Evidence need not be excluded solely because it is hearsay.

(b) All testimony of parties and witnesses shall be made under oath or affirmation and the presiding officer shall have the power to administer an oath or affirmation for that purpose.

(c) Statements presented by nonparties in accordance with paragraph (c) of K.S.A. 77-523 may be received as evidence.

(d) Any part of the evidence may be received in written form if doing so will expedite the hearing without substantial prejudice to the interests of any party.

(e) Documentary evidence may be received in the form of a copy or excerpt. Upon request, parties shall be given an opportunity to compare the copy with the original if available.

(f) Official notice may be taken of (1) any matter that could be judicially noticed in the courts of this state, (2) the record of other proceedings before the state agency, (3) technical or scientific matters within the state agency's specialized knowledge, and (4) codes of standards that have been adopted by an agency of the United States, of this state or of another state or by a nationally recognized organization or association. Parties shall be notified before or during the hearing, or before the issuance of any initial or final order that is based in whole or in part on matters or material noticed, of the specific matters or material noticed and the source thereof, including any staff memoranda and data, and be afforded an opportunity to contest and rebut the matters or material so noticed.

K.A.R. 81-11-10. Evidence. The presiding officer may relax the rules of evidence if it will aid in ascertaining the facts. The presiding officer shall admit hearsay evidence not otherwise admissible:

(a) unless a party objects to the proffered evidence and states that; (1) the party knows that a fact contained therein and offered to prove the truth of the matter is false; or (2) the party does not know whether a fact contained therein and offered to prove the truth of the matter is true and the presiding officer finds that after being given a reasonable time the party has been unable to ascertain the truth of the matter and has made a diligent effort to do so; or

(b) if the presiding officer finds that the evidence will aid in ascertaining the facts; or

(c) if the evidence proffered consists of answers to questionnaires directed to persons allegedly solicited to purchase or sell securities who are so numerous that it is impractical to call them as witnesses, all answers to questionnaires which were returned to the questioning party are proffered, and the evidence is offered to show a pattern in the alleged solicitations or in the class of persons allegedly solicited. The presiding officer may allow any other party a reasonable time to direct cross-examination questionnaires to and receive answers from such or similar persons allegedly solicited.

PowerPoint Presentation:

Regulatory Changes and Updates

By Steve Wassom, Randy Mullikin and Kenny Bossert

Kansas
Office of the Securities Commissioner

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OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Regulatory Changes and Updates

Steve Wassom
KSC

Randy Mullikin
KSC

Kenneth Bossert
SEC

Kansas
Office of the Securities Commissioner

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Elimination of Certain Requirements For Investment Advisers With Custody of Client Funds or Securities

- Surety Bond
- Notice of Fee Deduction
- Independent Audit of Balance Sheet
- Minimum Adjusted Net Worth

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Have you ever submitted a written comment in connection with a proposed rule change?

a) Yes

b) No

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Disclosure Requirement For All Investment Advisers Regarding Insurance Coverage

- Special Order 13E009 (11/7/2012)
- Supplement to Form ADV, Part 2 for delivery to all clients and prospective clients.
- State the presence or absence of professional liability insurance coverage for investment advisory services.
- Must provide evidence of coverage within 30 days of a request from a client.

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Professional Liability Insurance

Coverage that an insurer will pay on behalf of an insured adviser and its insured persons, the loss which they shall become legally obligated to pay as a result of a claim first made and reported during the policy period against the insured adviser or its insured persons for a wrongful act involving the rendering of or failure to render investment advisory services, which takes place during or prior to the policy period.

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"Investment Advisory Services"

Means financial, economic or investment advice regarding investments or investment management services performed or required to be performed for or on behalf of a customer pursuant to a written agreement between such customer and the insured adviser for a fee, commission or other monetary consideration or other remuneration which inures to the benefit of the insured adviser.

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Current Requirements Under K.A.R. 81-14-9, As Amended

- Safekeeping of client funds and securities (for IAs with custody)
- Financial reporting to KSC
- Positive net worth requirement

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Safekeeping Requirements

- Must use a "Qualified Custodian" to maintain funds and securities in account for client(s) of the investment adviser
- In most cases, the qualified custodian is a broker-dealer that holds client assets in compliance with SEC net capital rules as adopted by reference under K.A.R. 81-3-7(d)
- Notice to KSC (on form ADV) and to client to identify the qualified custodian

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Safekeeping Requirements Cont'd

- Account statements are required to be sent to clients at least quarterly
  - by the qualified custodian, or
  - by the investment adviser if it engages a CPA firm annually to attest to the accuracy of the account statements sent in comparison with qualified custodian records

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Safekeeping Requirements Cont'd

- An "Independent Representative" may be designated by clients to receive notice and account statements
- Written authorization is required from client for IA fees to be deducted from account maintained by qualified custodian
- Other requirements or exceptions are specified in K.A.R. 81-14-9(b) for safekeeping involving pooled investments, mutual funds, accounts of investment companies or beneficial trusts.

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Financial Reporting Requirements For Kansas-based Investment Advisers

- Maintain financial statements required by K.A.R. 81-14-4(b)(6):
  - Balance sheet prepared in accordance with GAAP
  - Income statement
  - Cash flow statement
- Balance sheets as of the end of each month are to be prepared within 10 days after the end of the month and available for filing with KSC within 5 days after a request by KSC staff.

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Financial Condition Requirements For Kansas-based Investment Advisers

- An investment adviser must maintain a positive net worth at all times.
- If an investment adviser is insolvent because its net worth is negative as reported on its balance sheet, it must notify the KSC by the close of business on the next business day, and
- Must file its balance sheet that states the insolvent financial condition.

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Kansas Private Adviser Exemption Provided by K.A.R. 81-14-11

To qualify for this exemption, an investment adviser must:

- Maintain its principal place of business in Kansas
- Provide investment advice solely to fewer than 15 clients
- Not hold out generally to the public as an investment adviser, and
- Not act as investment adviser to any investment company or to a business development company under the federal Investment Company Act of 1940

Investment adviser representatives associated with an IA that meets the conditions for exemption are also exempt from registration.

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Kansas Private Adviser Notice Filing Requirement

- If Assets under management are no more than $25 million as of December 31 each year,
- File notice with KSC by February 1 of following year with identifying information on form ADV Part 1A, Item 1
- No filing fee is required

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Kansas Private Adviser Exemption Cont'd

- If assets under management are in excess of $25 million, and
- The investment adviser is subject to SEC requirements to either:
  - Register with the SEC or
  - File with the SEC as an exempt reporting adviser, then
- No notice filing with KSC is required.

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Federal Regulatory Information Presented by SEC Staff

- Family Offices
- Exempt Reporting Advisers
- Mid-Size Advisers

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Solicitor

An "investment adviser representative" includes a person that receives compensation to solicit on behalf of an investment adviser. An investment adviser is prohibited from paying a solicitor a referral fee unless the individual is exempt from registration.

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Services of a Solicitor

- Generally the services of a solicitor are not "impersonal."
- A solicitor will conduct some level of due diligence of a third-party investment adviser.
- A solicitor will provide some level of analysis concerning suitability or performance.
- A solicitor may recommend terminating a third-party investment adviser.

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Disclosure Required by Solicitor Under K.A.R. 81-14-5(f)(6)

A disclosure document is required to be provided by the solicitor to client and must contain the name of the solicitor, the name of the investment adviser, the nature of the relationship between the solicitor and investment adviser, notice that the solicitor will be compensated for the solicitation by the investment adviser, and the terms of the compensation, including the amount in addition to the advisory fee that a client will be charged for the costs of the solicitor's services.

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Can an investment adviser compensate an existing client for referring a new client?

a) Yes

b) No

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What is the maximum dollar amount for the current gift rule administered by FINRA?

a) $100

b) $200

c) $300

d) $500

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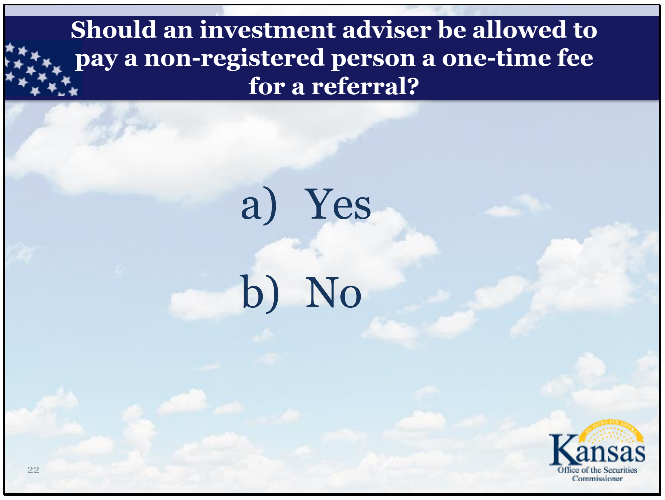

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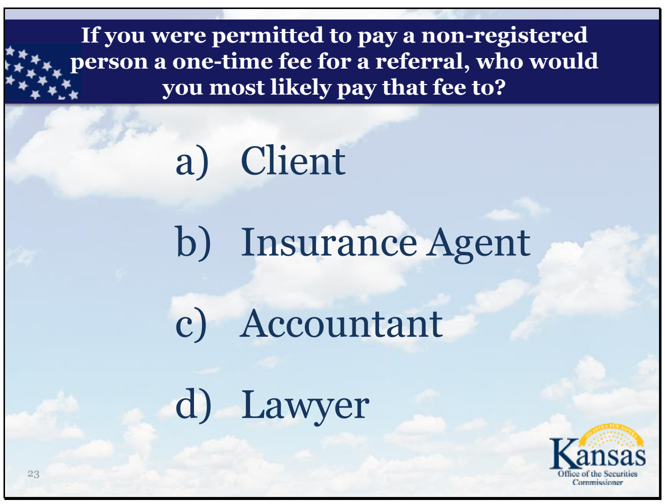

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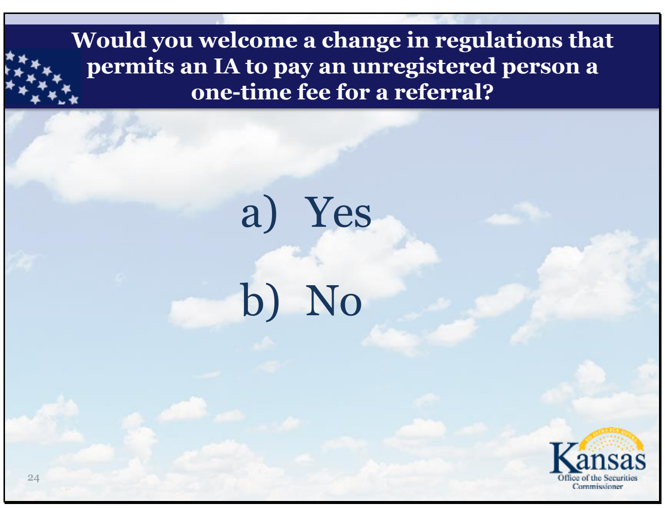

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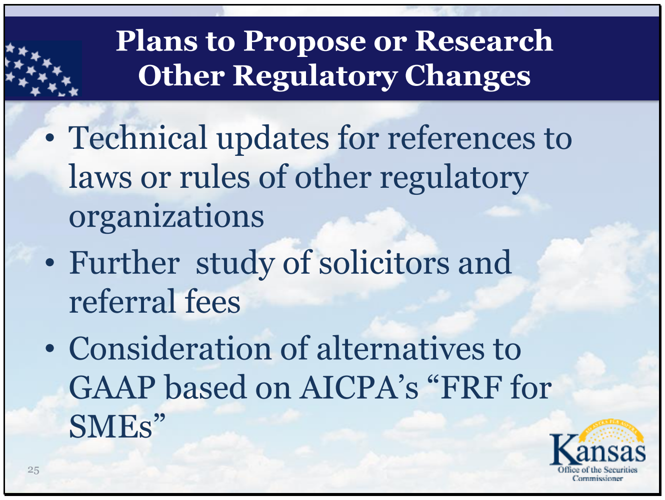

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Supplemental Materials:

Regulatory Changes and Updates

By Steve Wassom, Randy Mullikin and Kenny Bossert

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Kansas

Office of the Securities Commissioner

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF KANSAS

In re:)
)
Waiver of Bonding Requirements) Docket No. 12E 024
Under K.A.R. 81-14-9(e))
)

Special Order – Waiver of Surety Bond Requirements for Investment Advisers Under K.A.R. 81-14-9(e)

WHEREAS, the current version of K.A.R. 81-14-9(e) requires every investment adviser registered or required to be registered under the Kansas Uniform Securities Act (KUSA) that has custody or discretionary authority over client funds or securities to be bonded for at least $35,000; and

WHEREAS, the current version of K.A.R. 81-14-9(e) further provides under paragraph (1) that an additional bond may be required for an investment adviser that does not comply with requirements for minimum adjusted net worth; and

WHEREAS, staff for the Office of the Kansas Securities Commissioner have recommended that the surety bond requirements of K.A.R. 81-14-9(e) are no longer necessary, and therefore, should no longer be required; and

WHEREAS, K.S.A. 17-12a605 grants the Securities Commissioner the authority to issue special orders as necessary or appropriate to carry out the KUSA; and

WHEREAS, K.S.A. 17-12a406(e) grants the Securities Commissioner the authority to waive, in whole or in part, specific requirements in connection with the registration of investment advisers.

IT IS, THEREFORE, ORDERED BY THE COMMISSIONER that the surety bond requirements of K.A.R. 81-14-9(e) are hereby waived, and therefore, no longer required.

IT IS FURTHER ORDERED that this order shall be effective on the date indicated below and that it shall be automatically vacated upon the adoption of any future amendment to K.A.R. 81-14-9.

IT IS SO ORDERED.

Entered at Topeka, Kansas, on this 21st day of May, 2012.

[redacted]

Aaron Jack
Securities Commissioner

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Kansas
Securities Commissioner

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF KANSAS

In re:	)	
	)	
Waiver of Certain Requirements Under K.A.R. 81-14-9 and New Requirement Authorized by K.A.R. 81-14-10 for Disclosure Regarding Insurance Coverage	)	Docket No. 13E009

Special Order – Waiver of Certain Requirements for Investment Advisers Under K.A.R. 81-14-9 and New Requirement Authorized by K.A.R. 81-14-10 For Disclosure Regarding Insurance Coverage

WHEREAS, the current version of K.A.R. 81-14-9(b)(1)(F) requires every investment adviser registered or required to be registered under the Kansas Uniform Securities Act (KUSA) that has custody, as defined in paragraph (a)(2)(A)(ii), by having fees deducted from client accounts held by a qualified custodian, to provide a notice of fee deduction to the qualified custodian and concurrently provide an invoice for such fees to each client along with an itemization of the fee calculation; and

WHEREAS, the current version of K.A.R. 81-14-9(c)(1) requires each investment adviser that has custody of client funds or securities and each investment adviser that receives over $500 in fees six months or more in advance to have the balance sheet required by that subsection to be audited and reported upon by an independent CPA; and

WHEREAS, the current version of K.A.R. 81-14-9(d) requires every investment adviser registered or required to be registered under the KUSA that has custody or discretionary authority over client funds or securities to maintain at all times a minimum adjusted net worth, as defined by K.A.R. 81-14-9(a)(1), of $35,000 for investment advisers having custody, or $10,000 for investment advisers having discretionary authority over client funds or securities unless an exception specified by that subsection applies; and

WHEREAS, staff for the Office of the Kansas Securities Commissioner have recommended that the requirements for a notice of fee deduction, for the balance sheet to be audited, and for minimum adjusted net worth to be maintained as further described above with reference to various subsections of K.A.R. 81-14-9 are no longer necessary, and therefore, should no longer be required; and

WHEREAS, K.S.A. 17-12a411(g) grants the Securities Commissioner authority by a rule adopted or order issued under KUSA to require every investment adviser registered or required to be registered under KUSA to furnish or disseminate information to clients or prospective clients in this state as necessary or appropriate in the public interest and for the protection of investors and advisory clients; and

WHEREAS, K.A.R. 81-14-10(b)(2) requires each investment adviser registered or required to be registered under KUSA to provide to each client and prospective client a firm brochure and one or more supplements to contain all information required by Part 2 of Form ADV and any other relevant information that the Securities Commissioner may require; and

WHEREAS, K.S.A. 17-12a605 grants the Securities Commissioner the authority to issue special orders as necessary or appropriate to carry out the KUSA; and

WHEREAS, K.S.A. 17-12a406(e) grants the Securities Commissioner the authority by order issued under KUSA to waive, in whole or in part, specific requirements in connection with the registration of investment advisers or to impose other conditions not inconsistent with the National Securities Markets Improvement Act of 1996.

IT IS, THEREFORE, ORDERED BY THE COMMISSIONER that the requirements for a notice of fee deduction as specified by K.A.R. 81-14-9(b)(1)(F), the balance sheet audit as specified by K.A.R. 81-14-9(c)(1), and minimum adjusted net worth as specified by K.A.R. 81-14-9(d) are hereby waived, and therefore, no longer required.

IT IS FURTHER ORDERED that every investment adviser registered or required to be registered under KUSA shall attach a supplement to its brochure or Form ADV, Part 2 for delivery to all clients and prospective clients in this state which discloses the presence or absence of professional liability insurance coverage for its investment advisory services; and in the event a client or prospective client in Kansas requests proof of such professional liability insurance coverage, the investment adviser shall within 30 days provide a copy of the insurance agreement.

IT IS FURTHER ORDERED that this order shall be effective on the date indicated below and that it shall be automatically vacated upon the adoption of any future amendment to K.A.R. 81-14-9.

IT IS SO ORDERED.

Entered at Topeka, Kansas, on this 7th day of November, 2012.

[redacted]

Aaron Jack
Securities Commissioner

Office of the Securities Commissioner of Kansas
Kansas Administrative Regulation 81-14-9
Effective October 25, 2013

81-14-9. Custody of client funds or securities; safekeeping; financial reporting.

(a) Definitions. For the purposes of this regulation, the following definitions shall apply:

(1) "Custody" means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them or the ability to appropriate them.

(A) Each of the following circumstances shall be deemed to constitute custody:

(i) Possession of client funds or securities unless received inadvertently and returned to the sender promptly, but in any case within three business days of receiving the funds or securities;

(ii) any arrangement, including a general power of attorney, under which an investment adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon the adviser's instruction to the custodian; and

(iii) any arrangement that gives an investment adviser or its supervised person legal ownership of or access to client funds or securities, which may include an arrangement in which the investment adviser or its supervised person is the trustee of a trust, the general partner of a limited partnership, the managing member of a limited liability company, or a comparable position for a pooled investment vehicle.

(B) Receipt of a check drawn by a client and made payable to an unrelated third party shall not meet the definition of custody if the investment adviser forwards the check to the third party within three business days of receipt and the adviser maintains the records required under K.A.R. 81-14-4(b)(22).

(2) "Independent party" means a person that meets the following conditions:

(A) Is engaged by an investment adviser to act as a gatekeeper for the payment of fees, expenses, and capital withdrawals from a pooled investment;

(B) does not control, is not controlled by, and is not under common control with the investment adviser; and

(C) does not have, and has not had within the past two years, a material business relationship with the investment adviser.

(3) "Independent representative" means a person who meets the following conditions:

(A) Acts as an agent for an advisory client, which may include a person who acts as an agent for limited partners of a pooled investment vehicle structured as a limited partnership, members of a pooled investment vehicle structured as a limited liability company, or other beneficial owners of another type of pooled investment vehicle;

(B) is obliged by law or contract to act in the best interest of the advisory client or the limited partners, members, or other beneficial owners;

(C) does not control, is not controlled by, and is not under common control with the investment adviser; and

(D) does not have, and has not had within the past two years, a material business relationship with the investment adviser.

(4) "Qualified custodian" means any of the following independent institutions or entities:

(A) A bank or savings association that has deposits insured by the federal deposit insurance corporation;

(B) a broker-dealer registered under the act who holds client assets in customer accounts and complies with K.A.R. 81-3-7(d);

(C) a futures commission merchant registered under section 6f of the commodity exchange act, 7 U.S.C. § 6f, who holds client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity and options of the commodity for future delivery; and

(D) a foreign financial institution that customarily holds financial assets for its customers, if the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.

(b) Safekeeping of client funds and securities.

(1) Requirements. An investment adviser registered or required to be registered under the act shall not have custody of client funds or securities unless the investment adviser meets each of the following conditions. "An act, practice, or course of business that operates or would operate as a fraud or deceit," as used in K.S.A. 17-12a502 and amendments thereto, shall include any violation of this subsection.

(A) Notice to administrator. The investment adviser shall notify the administrator promptly on form ADV that the investment adviser has or will have custody.

(B) Qualified custodian. A qualified custodian shall maintain the funds and securities in a separate account for each client under each client's name, or in accounts that contain only funds and securities of the investment adviser's clients under the name of the investment adviser as agent or trustee for each client.

(C) Notice to clients. If an investment adviser opens an account with a qualified custodian on behalf of its client, either under the client's name or under the investment adviser's name as agent, the investment adviser shall notify the client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained. The notice shall be given promptly when the account is opened and following any changes to the information.

(D) Account statements. The investment adviser shall ensure that account statements are sent to each client for whom the adviser has custody of funds or securities.

(i) Statements sent by the qualified custodian. If a qualified custodian maintains accounts containing funds or securities, the qualified custodian may send account statements to clients if the investment adviser has a reasonable basis for believing that the qualified custodian sends an account statement at least quarterly to each of the adviser's clients for whom the custodian maintains funds or securities and that the account statement sets forth all transactions in the account during the period and identifies the amount of funds and amount of each security in the account at the end of the period.

(ii) Statements sent by the adviser. If account statements are not sent by the qualified custodian in accordance with paragraph (b)(1)(D)(i), the investment adviser shall send an account statement at least quarterly to each client for whom it has custody of funds or securities. The account statement shall set forth all transactions in the account during the period and identify the amount of funds and amount of each security of which it has custody at the end of the period. At least once during each calendar year, a CPA firm that is registered and authorized to provide attest services in compliance with requirements of the state where the investment adviser is domiciled shall be engaged by the investment adviser to attest to the accuracy, in all material respects, of the account statements sent to clients by the investment adviser based on a comparison with records of transactions and balances of funds and securities maintained by the qualified custodian. The attest engagement shall be performed in accordance with attestation standards established by the AICPA and contained in the "AICPA professional standards," as specified in K.A.R. 74-5-2. The CPA firm shall perform the attest engagement without prior notice or announcement to the adviser on a date that changes from year to year as chosen by the CPA firm. The CPA firm shall file a copy of its independent accountant's report with the administrator within 30 days after the completion of the attest engagement. The CPA firm, upon finding any material exceptions during the course of the engagement, shall notify the administrator of the finding within two business days by means of a facsimile transmission or electronic mail, followed by first-class mail, directed to the attention of the administrator.

(iii) Special rule for pooled investment vehicles. If the investment adviser is a general partner of a pooled investment vehicle structured as a limited partnership, is a managing member of a pooled investment vehicle structured as a limited liability company, or holds a comparable position for another type of pooled investment vehicle, the account statements required under this subsection shall be sent to each limited partner, member, or other beneficial owner or that person's independent representative.

(E) Independent representatives. A client may designate an independent representative to receive, on the client's behalf, notices and account statements as required under paragraphs (b)(1)(C) and (b)(1)(D). Thereafter, the investment adviser shall send all notices and statements to the independent representative.

(F) Direct fee deduction. Each investment adviser who has custody, as defined in paragraph (a)(1)(A)(ii), by having fees directly deducted from client accounts held by a qualified custodian shall obtain prior written authorization from the client to deduct advisory fees from the account held with the qualified custodian.

(G) Pooled investments. Each investment adviser who has custody, as defined in paragraph (a)(1)(A)(iii), and who does not meet the exception provided under paragraph (b)(2)(C) shall comply with each of the following requirements:

(i) Engage an independent party. The investment adviser shall hire an independent party to review all fees, expenses, and capital withdrawals from the pooled accounts.

(ii) Review of fees. The investment adviser shall send all invoices or receipts to the independent party, detailing the amount of the fee, expenses, or capital withdrawal and the method of calculation so that the independent party can determine that the payment is in accordance with the agreement governing the pooled investment vehicle and so that the independent party can forward to the qualified custodian approval for payment of an invoice with a copy to the investment adviser.

(iii) Notice of safeguards. The investment adviser shall notify the administrator on form ADV that the investment adviser intends to use the safeguards specified in this subsection.

(2) Exceptions.

(A) Shares of mutual funds. With respect to shares of a mutual fund that is an open-end company as defined in section 5(a)(1) of the investment company act of 1940, 15 U.S.C. 80a-5(a)(1), as adopted by reference in K.A.R. 81-2-1, any investment adviser may use the mutual fund's transfer agent in lieu of a qualified custodian for purposes of complying with paragraph (b)(1).

(B) Certain privately offered securities. An investment adviser shall not be required to comply with paragraph (b)(1) with respect to securities that meet the following conditions:

(i) Are acquired from the issuer in a transaction or chain of transactions not involving any public offering;

(ii) are uncertificated, with ownership of the securities recorded only on the books of the issuer or its transfer agent in the name of the client; and

(iii) are transferable only with the prior consent of the issuer or holders of the outstanding securities of the issuer.

(C) Limited partnerships subject to annual audit. An investment adviser shall not be required to comply with paragraph (b)(1) with respect to the account of a limited partnership, limited liability company, or other type of pooled investment vehicle that is subject to audit at least annually and that distributes its audited financial statements presented in conformity with GAAP to all limited partners, members, or other beneficial owners within 120 days after the end of its fiscal year. The investment adviser shall notify the administrator on form ADV that the investment adviser intends to distribute audited financial statements.

(D) Registered investment companies. An investment adviser shall not be required to comply with paragraph (b)(1) with respect to the account of an investment company registered under the investment company act of 1940, 15 U.S.C. 80a-1 et seq.

(E) Beneficial trusts. An investment adviser shall not be required to comply with the safekeeping requirements of paragraph (b)(1) if the investment adviser has custody solely because the investment adviser or an investment adviser representative is the trustee for a beneficial trust, if all of the following conditions are met for each trust:

(i) The beneficial owner of the trust is a parent, grandparent, spouse, sibling, child, or grandchild of the investment adviser representative, including "step" relationships.

(ii) The investment adviser provides a written statement to each beneficial owner of each account setting forth a description of the requirements of paragraph (b)(1) and the reasons why the investment adviser will not be complying with those requirements.

(iii) The investment adviser obtains from each beneficial owner a signed and dated statement acknowledging the receipt of the written statement.

(iv) The investment adviser maintains a copy of both documents described in paragraphs (b)(2)(E)(ii) and (iii) until the account is closed or the investment adviser or investment adviser representative is no longer trustee.

(F) Upon written request and for good cause shown, the requirement to use a qualified custodian may be waived by the administrator. As a condition of granting a waiver, the investment adviser may be required by the administrator to perform the duties of a qualified custodian as specified in paragraph (b)(1).

(c) Financial reporting requirements for investment advisers.

(1) Balance sheet. Each registered investment adviser shall prepare and maintain a balance sheet, as required by K.A.R. 81-14-4(b)(6), each month. The balance sheet shall be dated the last day of the month and shall be prepared within 10 business days after the end of the month. The investment adviser shall file the balance sheet with the administrator, for any month specified by the administrator, within five days after a request by the administrator.

(2) Exemptions. An investment adviser shall be exempt from the requirements of this subsection if the investment adviser has its principal place of business in a state other than Kansas, is properly registered in that state, and satisfies the financial reporting requirements of that state.

(d) Positive net worth requirement.

(1) Each investment adviser that is registered or required to be registered under the act shall maintain at all times a positive net worth.

(2) Notification. Each investment adviser registered or required to be registered under the act shall, by the close of business on the next business day, notify the administrator if the investment adviser is insolvent because its net worth is negative as determined in conformity with GAAP. The notification of insolvency shall include the investment adviser's balance sheet that states the insolvent financial condition on the date the insolvency occurred. Upon receiving the balance sheet, the administrator may require the investment adviser to file additional information by a specified date.

(3) Exception for out-of-state advisers. If an investment adviser has its principal place of business in a state other than Kansas and is properly registered in that state, the investment adviser shall be required to maintain the minimum capital required by the state in which the investment adviser maintains its principal place of business.

(Authorized by K.S.A. 17-12a502(b) and 17-12a605(a); implementing K.S.A. 17-12a411, as amended by L. 2013, ch. 65, sec. 3, and 17-12a502(a)(2); effective Aug. 18, 2006; amended Aug. 15, 2008; amended Oct. 25, 2013.)

Office of the Securities Commissioner of Kansas
Kansas Administrative Regulation 81-14-11
Effective October 25, 2013

81-14-11. Kansas private adviser exemption.

(a) Exemption from registration. An investment adviser shall be exempt from the registration requirements of K.S.A. 17-12a403, and amendments thereto, if both of the following requirements are met:

(1) The investment adviser shall meet each of the following conditions:

(A) Maintain its principal place of business in Kansas;

(B) provide investment advice solely to fewer than 15 clients;

(C) not hold itself out generally to the public as an investment adviser; and

(D) not act as an investment adviser to any investment company registered under the investment company act of 1940, 15 U.S.C. § 80a-1 et seq., or a company that has elected and has not withdrawn its election to be a business development company pursuant to section 54 of the investment company act of 1940, 15 U.S.C. § 80a-54.

(2) Neither the investment adviser nor any of its advisory affiliates or associated investment adviser representatives shall be subject to a disqualification provision as described in rule 262 of SEC regulation A, 17 C.F.R. § 230.262, as adopted by reference in K.A.R. 81-2-1.

(b) Notice filing. Each investment adviser that qualifies for exemption under subsection (a) shall be subject to or exempt from filing a notice with the administrator as follows:

(1) Notice filing requirement. Each investment adviser that manages assets of no more than $25 million on December 31 each year shall complete the identifying information required by item 1 of form ADV, part 1A and file the printed form with the administrator on or before February 1 of the following year. No fee shall be required with the notice filing required by this subsection.

(2) Exemption from notice filing requirement. Each investment adviser that manages assets in excess of $25 million and is registered with the SEC shall be exempt from the notice filing requirements of K.S.A. 17-12a405, and amendments thereto, and of paragraph (1) of this subsection.

(c) Exemption for investment adviser representatives. An investment adviser representative shall be exempt from the registration requirements of K.S.A. 17-12a404, and amendments thereto, if the individual meets the following requirements:

(1) Is employed by or associated with an investment adviser that meets the exemption requirements under subsection (a);

(2) is not subject to a disqualification as described in rule 262 of SEC regulation A, 17 C.F.R. § 230.262; and

(3) does not otherwise act as an investment adviser representative.

(d) Transition. Each investment adviser or investment adviser representative who becomes ineligible for the exemption specified in this regulation shall comply with the registration or notice filing requirements under the act within 90 days after the date of ineligibility.

(Authorized by K.S.A. 17-12a605(a); implementing K.S.A. 17-12a403(b)(3), 17-12a404(b)(2), and 17-12a405(b)(3); effective Oct. 25, 2013.)

U.S. Securities and Exchange Commission

SEC Adopts Rule Under Dodd-Frank Act Defining "Family Offices"

FOR IMMEDIATE RELEASE
2011-134

Washington, D.C., June 22, 2011 — The Securities and Exchange Commission today approved a new rule to define "family offices" that are to be excluded from the Investment Advisers Act of 1940.

The rulemaking stems from the Dodd-Frank Wall Street Reform and Consumer Protection Act.

"Family offices" are entities established by wealthy families to manage their wealth and provide other services to family members, such as tax and estate planning services. Historically, family offices have not been required to register with the SEC under the Advisers Act because of an exemption provided to investment advisers with fewer than 15 clients.

Video: Open Meeting

Chairman Schapiro discusses family offices: Windows Media Player

Text of Chairman's statement

The Dodd-Frank Act removed that exemption so the SEC can regulate hedge fund and other private fund advisers. However, Dodd-Frank also included a new provision requiring the SEC to define family offices in order to exempt them from regulation under the Advisers Act.

The new rule adopted by the SEC enables those managing their own family's financial portfolios to determine whether their "family offices" can continue to be excluded from the Investment Advisers Act.

The rule is effective 60 days after its publication in the *Federal Register*.

# # #

FACT SHEET

Defining A Family Office

How are family offices impacted by the Dodd-Frank Act?

Family offices typically are considered to be investment advisers under the Advisers Act because of the investment advisory services that they provide.

As such, they are subject to the registration requirements set forth in that Act. Historically, however, most family offices have been structured to take advantage of an exemption from registration for firms that advise less than fifteen clients and meet certain other conditions.

The Dodd-Frank Act repeals the 15-client exemption to enable the SEC to regulate hedge fund and other private fund advisers. But, the Dodd-Frank Act includes a new provision requiring the SEC to define family offices in order to exempt them from regulation under the Advisers Act.

Today, the Commission is considering adopting a final rule defining family offices that will be excluded from regulation under the Advisers Act.

Which family offices will be excluded from Advisers Act regulation under the rule?

Any company that:

- Provides investment advice only to "family clients," as defined by the rule.
- Is wholly owned by family clients and is exclusively controlled by family members and/or family entities, as defined by the rule.
- Does not hold itself out to the public as an investment adviser.

Which family members and employees can the family office advise under the exclusion?

- *Family members.* Family members include all lineal descendants (including by adoption, stepchildren, foster children, and, in some cases, by legal guardianship) of a common ancestor (who is no more than 10 generations removed from the youngest generation of family members), and such lineal descendants' spouses or spousal equivalents.
- *Key employees.* Key employees include:
  - Executive officers, directors, trustees, general partners, or persons serving in a similar capacity for the family office or its affiliated family office.
  - Any other employee of the family office or its affiliated family office (other than a clerical or secretarial employee) who, in connection with his or her regular duties, has participated in the investment activities of the family office or affiliated family office, or similar functions or duties for another company, for at least 12 months.
- *Other family clients.* Other family clients generally include:
  - Any non-profit or charitable organization funded exclusively by family clients.

- Any estate of a family member, former family member, key employee, or subject to certain conditions a former key employee.
- Certain family client trusts.
- Any company wholly-owned by and operated for the sole benefit of family clients.

When will family offices have to register with the Commission under the Advisers Act or with applicable state securities authorities if they do not meet the terms of the exclusion?

By March 30, 2012.

Will existing family office exemptive orders be rescinded?

No. Family offices that obtained exemptive orders from the Commission will be able to continue operating under their existing exemptive orders or they may operate under the new rule.

What if a family office will not meet the exclusion on March 30, 2012?

That family office will have to obtain a Commission exemptive order or register as an investment adviser.

Grandfathering Provision

The Dodd-Frank Act requires that the Commission not preclude certain family offices from meeting the new exclusion solely because they provide investment advice to certain clients (and provided that advice prior to January 1, 2010). The adopted rule incorporates this grandfathering provision.

http://www.sec.gov/news/press/2011/2011-134.htm

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SEC Adopts Dodd-Frank Act Amendments to Investment Advisers Act

FOR IMMEDIATE RELEASE
2011-133

Washington, D.C., June 22, 2011 – The Securities and Exchange Commission today adopted rules that require advisers to hedge funds and other private funds to register with the SEC, establish new exemptions from SEC registration and reporting requirements for certain advisers, and reallocate regulatory responsibility for advisers between the SEC and states.

Video: Open Meeting

Chairman Schapiro discusses amendments to Investment Advisers Act:
Windows Media Player

Text of Chairman's statement

The rules adopted by the Commission implement core provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding investment advisers, including those that advise hedge funds.

"These rules will fill a key gap in the regulatory landscape," said SEC Chairman Mary L. Schapiro. "In particular, our proposal will give the Commission, and the public, insight into hedge fund and other private fund managers who previously conducted their work under the radar and outside the vision of regulators."

In addition, the Commission amended rules to expand disclosure by investment advisers, particularly about the private funds they manage, and revised the Commission's pay-to-play rule.

The rules implement a transitional exemption period so that private advisers, including hedge fund and private equity fund advisers, newly required to register do not have to do so until March 30, 2012. The rules regarding exemptions for venture capital fund and certain private fund advisers are effective July 21, 2011.

# # #

FACT SHEET

Dodd-Frank Act Amendments to the Investment Advisers Act

Background

A large number of individuals and institutions invest a significant amount of assets in private funds, such as hedge funds and private equity funds. However, until the passage of the Dodd-Frank Act, advisers managing those assets were subject to little regulatory oversight.

With the Dodd-Frank Act, Congress closed this regulatory gap by generally extending the registration requirements under the Investment Advisers Act to the advisers of these funds. The new law also provided the Commission with the ability to require the limited number of advisers to private funds that will not have to register to file reports about their business activities.

Further, in acknowledging the Commission's limited examination resources – and in light of the new responsibilities for private fund advisers – the Dodd-Frank Act reallocated regulatory responsibility for certain mid-sized investment advisers to the state securities authorities.

Private Fund Advisers and Commission Registration

For many years, advisers to private funds have been able to avoid registering with the Commission because of an exemption that applies to advisers with fewer than 15 clients – an exemption that counted each fund as a client, as opposed to each investor in a fund. As a result, some advisers to hedge funds and other private funds have remained outside of the Commission's regulatory oversight even though those advisers could be managing large sums of money for the benefit of hundreds of investors.

Title IV of the Dodd-Frank Act eliminated this private adviser exemption. Consequently, many previously unregistered advisers, particularly those to hedge funds and private equity funds, will have to register with the Commission and be subject to its regulatory oversight, rules and examination.

These advisers will be subject to the same registration requirements, regulatory oversight, and other requirements that apply to other SEC-registered investment advisers. To provide these advisers with a window to meet their new obligations, the transition provisions the Commission is adopting today will require these advisers to be registered with the Commission by March 30, 2012.

Reporting Requirements for Hedge Fund and Other Investment Advisers

Background

When investment advisers register with the Commission, they provide information in their registration form that is not only used for registration purposes, but that is used by the Commission in its regulatory program to support its mission to protect investors.

To enhance its ability to oversee investment advisers to private funds, the Commission is requiring advisers to provide additional information about the private funds they manage. The information obtained as a result of these amendments will assist the Commission in fulfilling its increased responsibility for private fund advisers arising from the Dodd-Frank Act.

The Form

Under the amended adviser registration form, advisers to private funds will have to provide:

- Basic organizational and operational information about each fund they manage, such as the type of private fund that it is (e.g., hedge fund, private equity fund, or liquidity fund), general information about the size and ownership of the fund, general fund data, and the adviser's services to the fund.

- Identification of five categories of "gatekeepers" that perform critical roles for advisers and the private funds they manage (i.e., auditors, prime brokers, custodians, administrators and marketers).

These reporting requirements are designed to help identify practices that may harm investors, deter advisers' fraud, and facilitate earlier discovery of potential misconduct. And this information will provide for the first time a census of this important area of the asset management industry.

In addition, the Commission is adopting other amendments to the adviser registration form to improve its regulatory program. These amendments will require all registered advisers to provide more information about their advisory business, including information about:

- The types of clients they advise, their employees, and their advisory activities.

- Their business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements and compensation for client referrals).

The rules also will require advisers to provide additional information about their non-advisory activities and their financial industry affiliations.

Reporting Requirements for Exempt Advisers

Background

While many private fund advisers will be required to register, some of those advisers may not need to if they are able to rely on one of three new exemptions from registration under the Dodd-Frank Act, including exemptions for:

- Advisers solely to venture capital funds.

- Advisers solely to private funds with less than $150 million in assets under management in the U.S.

- Certain foreign advisers without a place of business in the U.S.

The Commission can still impose certain reporting requirements upon advisers relying upon either of the first two of these exemptions ("exempt reporting advisers").

The Rules

Under the new rules, exempt reporting advisers will nonetheless be required to file, and periodically update, reports with the Commission, using the same registration form as registered advisers.

Rather than completing all of the items on the form, exempt reporting advisers will fill out a limited subset of items, including:

- Basic identifying information for the adviser and the identity of its owners and affiliates.
- Information about the private funds the adviser manages and about other business activities that the adviser and its affiliates are engaged in that present conflicts of interest that may suggest significant risk to clients.
- The disciplinary history (if any) of the adviser and its employees that may reflect on the integrity of the firm. Exempt reporting advisers will file reports on the Commission's investment adviser electronic filing system (IARD), and these reports will be publicly available on the Commission's website. These advisers will be required to file their first reports in the first quarter of 2012.

Reallocation of Regulatory Responsibility

Background

Since 1996, regulatory responsibility for investment advisers has been divided between the Commission and the states, primarily based on the amount of money an adviser manages for its clients. Under existing law, advisers generally may not register with the Commission unless they manage at least $25 million for their clients.

The Dodd-Frank Act raises the threshold for Commission registration to $100 million by creating a new category of advisers called "mid-sized advisers." A mid-sized adviser, which generally may not register with the Commission and will be subject to state registration, is defined as an adviser that:

- Manages between $25 million and $100 million for its clients.
- Is required to be registered in the state where it maintains its principal office and place of business.
- Would be subject to examination by that state, if required to register.

As a result of this amendment to the Investment Advisers Act, about 3,200 of the current 11,500 registered advisers will switch from registration with the Commission to registration with the states. These advisers will continue to be subject to the Advisers Act's general anti-fraud provisions.

The Rules

The Commission is adopting amendments to several of its current rules and forms to:

- Reflect the higher threshold required for Commission registration.
- Provide a buffer to prevent advisers from having to frequently switch between Commission and state registration.
- Clarify when an adviser will be a mid-sized adviser.
- Facilitate the transition of advisers between federal and state registration in accordance with the new requirements. Advisers registered with the Commission will have to declare that they are permitted to remain registered in a filing in the first quarter of 2012, and those no longer eligible for Commission registration will have until June 28, 2012 to complete the switch to state registration.

Pay-to-Play

The Rule

The Commission also is amending the investment adviser "pay-to-play" rule in response to changes made by the Dodd-Frank Act. The pay to play rule is designed to prevent an adviser from seeking to influence government officials' awards of advisory contracts through political contributions.

Under the amendment, an adviser will be permitted to pay a registered municipal advisor to act as a placement agent to solicit government entities on its behalf, if the municipal advisor is subject to a pay-to-play rule adopted by the MSRB that is at least as stringent as the investment adviser pay-to-play rule. The MSRB received new authority over municipal advisors under the Dodd-Frank Act. Advisers will also continue to be permitted to hire as a placement agent an SEC registered investment adviser or a broker-dealer that is subject to a pay-to-play rule adopted by FINRA that is at least as stringent as the investment adviser pay-to-play rule.

* * *

Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers

Background

As previously described, the Dodd-Frank Act eliminated the private adviser exemption and created three new exemptions for:

- Advisers solely to venture capital funds.
- Advisers solely to private funds with less than $150 million in assets under management in the United States.
- Certain foreign advisers without a place of business in the United States.

The Commission is adopting rules that would implement these exemptions and define various terms.

New Exemptions

Definition of Venture Capital Fund

The Dodd-Frank Act amended the Advisers Act to exempt from registration advisers that only manage venture capital funds, and directed the Commission to define the term "venture capital fund." The Commission is adopting a definition of "venture capital fund" that is designed to effect Congress' intent in enacting this exemption.

Under the definition, a venture capital fund is a private fund that:

- Invests primarily in "qualifying investments" (generally, private, operating companies that do not distribute proceeds from debt financings in exchange for the fund's investment in the company); may invest in a "basket" of non-qualifying investments of up to 20 percent of its committed capital; and may hold certain short-term investments.
- Is not leveraged except for a minimal amount on a short-term basis.
- Does not offer redemption rights to its investors.
- Represents itself to investors as pursuing a venture capital strategy.

Under a grandfathering provision, funds that began raising capital by the end of 2010 and represented themselves as pursuing a venture capital strategy would generally be considered venture capital funds. The Commission is adopting this approach because it could be difficult or impossible for advisers to conform these pre-existing funds, which generally have terms in excess of 10 years, to the new definition.

Private Fund Advisers With Less Than $150 Million in Assets Under Management in U.S.

The Commission also is adopting a rule that would implement the new statutory exemption for private fund advisers with less than $150 million in assets under management in the United States. The rule largely tracks the provision of the statute.

Foreign Private Advisers

The Dodd-Frank Act also amended the Advisers Act to provide for an exemption from registration for foreign advisers that do not have a place of business in the United States, and have:

- Less than $25 million in aggregate assets under management from U.S. clients and private fund investors.
- Fewer than 15 U.S. clients and private fund investors.

The Commission is adopting rules to define certain terms included in the statutory definition of "foreign private adviser" in order to clarify the application of the foreign private adviser exemption and reduce the potential burdens for advisers that seek to rely on it. The rule incorporates definitions set forth in other Commission rules, all of which are likely to be familiar to foreign advisers active in the U.S. capital markets.

http://www.sec.gov/news/press/2011/2011-133.htm

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Division of Investment Management: Frequently Asked Questions Regarding Mid-Sized Advisers

What is a "mid-sized adviser"?

A "mid-sized adviser" is an investment adviser that has between $25 million and $100 million of assets under management.

Are mid-sized advisers required to register with the Securities and Exchange Commission?

After July 21, 2011, a mid-sized adviser must register with the Securities and Exchange Commission if it:

i. is not required to be registered as an adviser with the state securities authority in the state where it maintains its principal office and place of business; or
ii. is not subject to examination as an adviser by the state where it maintains its principal office and place of business.

A mid-sized adviser that does not meet either one of these two requirements is prohibited from registering as an adviser with the Commission after July 21, 2011, but will have to register with the state securities authorities. There are a few exceptions to the general prohibition from SEC registration in rule 203A-2, such as for certain multi-state investment advisers and pension consultants. In addition, a mid-sized adviser that is required to register with the SEC, may elect to not register if it can rely on an exemption from registration, such as those for certain advisers to private funds.

In which states would a mid-sized adviser not be "subject to examination" by the state securities authority?

New York or Wyoming.

A mid-sized adviser with its principal office and place of business in either of those states is not "subject to examination" by the state securities authority and would have to register with the SEC. A mid-sized adviser with its principal office and place of business in any other state is "subject to examination." This information will be updated promptly upon notification by a state securities authority of any change to examination status.

How does a mid-sized adviser determine if it is "required to be registered" in the state where it maintains its principal office and place of business?

A mid-sized adviser should consult the investment adviser laws or the state securities authority for that state to determine if it is required to register as an investment adviser in that state.

When is a mid-sized adviser that is no longer eligible for Commission registration required to switch to state registration?

A mid-sized adviser registered with the Commission as of July 21, 2011 must remain registered with the Commission until January 1, 2012 (unless an exemption from Commission registration is available). Each adviser registered with the Commission on January 1, 2012 must file an amendment to its Form ADV no later than March 30, 2012, which for most advisers will be their annual updating amendment. A mid-sized adviser that is no longer eligible for Commission registration will need to be registered with the state securities authorities by June 28, 2012, and must withdraw its Commission registration by filing Form ADV-W, indicating it is filing a "partial withdrawal," no later than that date.

The adopting release amending Form ADV, dated June 22, 2011 (the "Adopting Release") can be found at: http://www.sec.gov/rules/final/2011/ia-3221.pdf .

Amended Form ADV can be found at: http://www.sec.gov/rules/final/2011/ia-3221-appd.pdf .

Amended Form ADV instructions can be found at: http://www.sec.gov/rules/final/2011/ia-3221-appa.pdf and http://www.sec.gov/rules/final/2011/ia-3221-appb.pdf .

http://www.sec.gov/divisions/investment/midsizedadviserinfo.htm

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PowerPoint Presentation:

Common Exemptions under the Kansas Uniform Securities Act

By Lynn Hammes

Slide 1

OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Common Exemptions Under the Kansas Uniform Securities Act

Presenter: Lynn Hammes

Kansas
Office of the Securities Commissioner

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Slide 2

All Sales of Securities Fall Into One of the Following Categories:

K.S.A. 17-12a301

- Federally Covered
  - §18(b)(2) of the 33 Act
  - Notice filing requirement (K.S.A. 17-12a302)
- Registered
  - By Coordination (K.S.A. 17-12a303)
  - By Qualification (K.S.A. 17-12a304)
- Exempt
  - Exempt Securities (K.S.A. 17-12a201)
  - Exempt Transactions (K.S.A. 17-12a202)
  - Other (K.S.A.17-12a203)
- Illegal

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Slide 3

Every offer or sale of a security in Kansas is either:

1. Federally Covered,
2. Registered,
3. Exempt, or
4. Illegal

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Slide 4

Institutional Investor

K.S.A. 17-12a202(13)

- Transactional exemption
- Allows for sales to:
  - Institutional investors
  - Federally covered investment advisors
- Self-executing
- No fees

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Office of the Securities Commissioner

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Slide 5

Limited Offering

K.S.A. 17-12a202(14)

- Transactional exemption
- Allows an issuer to sell securities:
  - In a single issue
  - To no more than 25 purchasers in Kansas during any 12 consecutive months
  - No general solicitation
  - No commissions other than to a broker-dealer or agent registered in Kansas
  - Purchase is made for investment and not for resale
- Self-executing
- No fees

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Office of the Securities Commissioner

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Slide 6

Existing Security Holder

K.S.A. 17-12a202(15)

- Transactional Exemption
- Includes Holders of:
  - Convertible Securities
  - Options
  - Warrants
- No Commissions
- Self-executing
- No fees

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Office of the Securities Commissioner

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Slide 7

Employee Benefit Plans

K.S.A. 17-12a202(21)

- Transactional exemption
- Generally modeled after Rule 701 of the 33 Act
- In addition to employees, the exemption covers offers or sales to:
  - Directors, general partners, trustees, officers, consultants and advisors
  - Family members
  - Former employees, directors, general partners, trustees, officers, consultants and advisors
  - Insurance agents
- Self-executing
- No fees

Slide 8

Oil & Gas

K.A.R. 81-5-10
(Implementing K.S.A. 17-12a203)

- Applies to any offer or sale of the following:
  - Limited partnership interests
  - Fractional undivided interests (FUI)
  - Certificate based FUI involving royalties, leases or deeds
- Land <u>must be</u> located in Kansas

Slide 9

Oil & Gas Cont'd

- Sales must meet one of the following:
  - Made to a person primarily engaged in oil and gas business during the preceding 2 years
  - Made to not more than 32 purchasers, regardless of state of residence.
    - Purchased for investment and not for resale
    - No general solicitation
    - No commissions
    - Property must produce oil, gas or petroleum products in paying quantities on and after the date of sale, seller cannot retain ownership interest or control over the lease or interest(s) being sold
- Self-executing
- No fees

Slide 10

Invest Kansas Exemption (IKE)

K.A.R. 81-4-21
(Implementing K.S.A. 17-12a203)

- Issuer is a business or organization formed under the laws of the state of Kansas
- Sales to Kansas residents only (§3(a)(11) and Rule 147 of the 33 Act)
- Limited to $1,000,000 reduced by sales during the preceding 12 month period

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Kansas
Office of the Securities Commissioner

Slide 11

IKE Cont'd

- Sales to any one purchaser limited to $5,000, unless "accredited" as defined by Regulation D, Rule 501 of the 33 Act
- No commissions other than to a broker-dealer or agent registered in Kansas
- General solicitation
- Notice on Form IKE
- No fees

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Kansas
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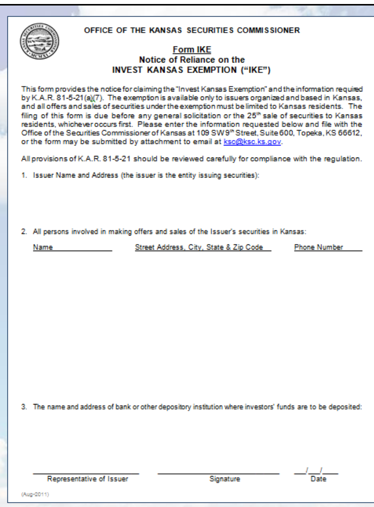
Slide 12



OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Form IKE
Notice of Reliance on the
INVEST KANSAS EXEMPTION ("IKE")

This form provides the notice for claiming the "Invest Kansas Exemption" and the information required by K.A.R. 81-5-21(a)(7). The exemption is available only to issuers organized and based in Kansas, and all offers and sales of securities under the exemption must be limited to Kansas residents. The filing of this form is due before any general solicitation or the 25th sale of securities to Kansas residents, whichever occurs first. Please enter the information requested below and file with the Office of the Securities Commissioner of Kansas at 109 SW 9th Street, Suite 600, Topeka, KS 66612, or the form may be submitted by attachment to email at ksc@ksc.ks.gov.

All provisions of K.A.R. 81-5-21 should be reviewed carefully for compliance with the regulation.

1. Issuer Name and Address (the issuer is the entity issuing securities):

2. All persons involved in making offers and sales of the Issuer's securities in Kansas:

Name	Street Address, City, State & Zip Code	Phone Number

3. The name and address of bank or other depository institution where investors' funds are to be deposited:

Representative of Issuer   Signature   __/__/__ Date

(Aug-2011)

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Kansas
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Audits or Inspections

K.S.A. 17-12a411(d)

- Subjects the records of every issuer subject to the Kansas Uniform Securities Act to audit or inspection

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Evidentiary Burden

K.S.A. 17-12a503

- In a civil action, as well as an administrative or criminal proceeding, the person claiming the exemption has the burden of proof

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Kansas
Office of the Securities Commissioner

Supplemental Materials:

Common Exemptions under the Kansas Uniform Securities Act

By Lynn Hammes

SEC DIVISION OF CORPORATION FINANCE

COMPLIANCE AND DISCLOSURE INTERPRETATIONS

Question 141.03

Question: If an issuer plans to conduct an intrastate offering pursuant to the Section 3(a)(11) exemption, may the issuer engage in general advertising or a general solicitation?

Answer: Securities Act Rule 147 does not prohibit general advertising or general solicitation. Any such general advertising or solicitation, however, must be conducted in a manner consistent with the requirement that offers made in reliance on Section 3(a)(11) and Rule 147 be made only to persons resident within the state or territory of which the issuer is a resident. [April 10, 2014]

Question 141.04

Question: An issuer plans to use a third-party Internet portal to promote an offering to residents of a single state in accordance with a state statute or regulation intended to enable securities crowdfunding within that state. Assuming the issuer met the other conditions of Rule 147, could it rely on Rule 147 for an exemption from Securities Act registration for the offering, or would use of an Internet portal necessarily entail making offers to persons outside the relevant state or territory?

Answer: Use of the Internet would not be incompatible with a claim of exemption under Rule 147 if the portal implements adequate measures so that offers of securities are made only to persons resident in the relevant state or territory. In the context of an offering conducted in accordance with state crowdfunding requirements, such measures would include, at a minimum, disclaimers and restrictive legends making it clear that the offering is limited to residents of the relevant state under applicable law, and limiting access to information about specific investment opportunities to persons who confirm they are residents of the relevant state (for example, by providing a representation as to residence or in-state residence information, such as a zip code or residence address). Of course, any issuer seeking to rely on Rule 147 for the offering also would have to meet all the other conditions of Rule 147. [April 10, 2014]

Question 141.05

Question: Can an issuer use its own website or social media presence to offer securities in a manner consistent with Rule 147?

Answer: Issuers generally use their websites and social media presence to advertise their market presence in a broad, indiscriminate manner. Although whether a particular communication is an "offer" of securities will depend on all of the facts and circumstances, using such established Internet presence to convey information about specific investment opportunities would likely involve offers to residents outside the particular state in which the issuer did business. [April 10, 2014]

FILED
JUN 21 2013
Kansas
Securities Commissioner

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF KANSAS

In re:	)	
	)	
Modifications of "IKE", the Invest Kansas Exemption under K.A.R. 81-5-21	)))	Docket No. 13E024

Special Order – Authorizing Certain Modifications of Conditions for the Invest Kansas Exemption, "IKE", Under K.A.R. 81-5-21

WHEREAS, the Invest Kansas Exemption, "IKE", as specified by K.A.R. 81-5-21was adopted by the Office of the Securities Commissioner of Kansas effective August 12, 2011 in order to remove certain regulatory requirements for Kansas companies to raise capital in Kansas; and

WHEREAS, staff in the Office of the Securities Commissioner of Kansas have recommended, and the Commissioner concurs, that it would be in the public interest to enhance the usefulness of IKE for Kansas businesses to raise capital without registration of community-based offerings of securities to Kansas residents by modifying certain limitations specified for IKE under K.A.R. 81-5-21; and

WHEREAS, the Commissioner and the Commissioner's staff believe that investor protection will not be adversely affected by modifications to IKE; and

WHEREAS, benefits to businesses organized under Kansas law and thereby to the Kansas economy are expected to be enhanced by such modifications to IKE; and

WHEREAS, K.S.A. 17-12a203, and amendments thereto, grants the Securities Commissioner authority by a rule adopted or order issued under the Kansas Uniform Securities Act (the Act) to exempt a security, transaction, or offer of securities from registration requirements under K.S.A. 17-12a301 through 17-12a306, and amendments thereto; and

WHEREAS, it is deemed appropriate for this order to modify the exemption conditions specified under K.A.R. 81-5-21 for an offer of securities under that exemption as authorized by K.S.A. 17-12a203, and amendments thereto; and

WHEREAS, K.S.A. 17-12a605, and amendments thereto, grants the Securities Commissioner the authority to issue special orders as necessary or appropriate in the public interest to carry out and to be consistent with the purposes of the Act.

IT IS, THEREFORE, ORDERED BY THE COMMISSIONER that the limitation on the amount an issuer can accept from a purchaser of securities who is not an accredited investor in an IKE offering as specified by K.A.R. 81-5-21(a)(4) is hereby increased from $1,000 to $5,000.

IT IS FURTHER ORDERED that K.A.R. 81-5-21(b) is revised to specify as follows: "Interaction with other exemptions and offers and sales to controlling persons. This exemption shall not be used in conjunction with any other exemption under these regulations or an exemption specified by a subsection other than subsections (13) through (15) under K.S.A. 17-12a202, and amendments thereto. Sales to controlling persons shall not count toward the limitation in paragraph (a)(3)."

IT IS FUTHER ORDERED that the exemption provided by K.A.R. 81-5-21 shall not be available to an issuer unless all persons responsible for management of the operations or property of the issuer are residents of Kansas.

IT IS FURTHER ORDERED that this order shall be effective on the date indicated below and that it shall be automatically vacated upon the adoption of any future amendment to K.A.R. 81-5-21.

IT IS SO ORDERED.

Entered at Topeka, Kansas, on this 21st day of June, 2013.

OFFICE OF THE SECURITIES COMMISSIONER KANSAS

[redacted]

Joshua A. Ney
Interim Commissioner

Notes